

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

- ☒ **Annual Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934**
For The Fiscal Year Ended December 31, 2007
- ☐ **Transition Report Pursuant To Section 13 Or 15(d) Of The Securities Exchange Act Of 1934**

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 Blvd., Suite 300, Houston, TX
(Address of principal executive offices)

77056
(Zip Code)

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Common Stock, \$.01 Par Value
Series G Preferred Stock Purchase Rights
(Title Of Class)

New York Stock Exchange
New York Stock Exchange
(Name of Exchange on which registered)

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933.
Yes ☐ No ☒

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.
Yes ☐ No ☒

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes ☒ No ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerator filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ☐ Accelerated filer ☒ Non-Accelerated filer ☐ Smaller Reporting Company ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company as defined by Rule 12b-2 of the Securities Exchange Act of 1934.
Yes ☐ No ☒

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 29, 2007 was approximately \$140.7 million based on the closing price of \$8.26 per share on the New York Stock Exchange.

The number of shares of the registrant's Common Stock, \$.01 par value per share, outstanding as of February 29, 2008 was 19,260,820.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be delivered in connection with the 2008 annual meeting of stockholders are incorporated in Part III of this Report.

TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

ITEM 1A. RISK FACTORS

ITEM 1B. UNRESOLVED STAFF COMMENTS

ITEM 2. PROPERTIES

ITEM 3. LEGAL PROCEEDINGS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

ITEM 6. SELECTED FINANCIAL DATA

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

ITEM 9A. CONTROLS AND PROCEDURES

ITEM 9B. OTHER INFORMATION

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

ITEM 11. EXECUTIVE COMPENSATION

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Employment Agreement

Asset Purchase Agreement

Calculation of Ratio of Earnings to Fixed Charges

Subsidiaries of the Company

Consent of KPMG LLP

Certification of Periodic Financial Reports by Melvin C. Payne Pursuant to Section 302

Certification of Periodic Financial Reports by Joseph Saporito Pursuant to Section 302

Certification of Periodic Financial Reports by Melvin C. Payne and Joseph Saporito Pursuant to Section 906

CAUTIONARY NOTE

This annual report contains forward-looking statements of our management regarding factors that we believe may affect our performance in the future. Such statements typically are identified by terms expressing our future expectations or projections of revenues, earnings, earnings per share, cash flow, market share, capital expenditures, effects of operating and acquisition initiatives, gross profit margin, debt levels, interest costs, tax benefits and other financial items. All forward-looking statements, although made in good faith, are based on assumptions about future events and are therefore inherently uncertain, and actual results may differ materially from those expected or projected. Important factors that may cause our actual results to differ materially from expectations or projections include those described under the heading “Forward-Looking Statements” in Item 7. Forward-looking statements speak only as of the date of this report, and we undertake no obligation to update or revise such statements to reflect new circumstances or unanticipated events as they occur.

PART I

ITEM 1. BUSINESS

GENERAL

We are a leading provider of death care services and merchandise in the United States. We operate two types of businesses: funeral homes, which currently account for approximately 75% of our total revenue, and cemeteries, which currently account for approximately 25% of our total revenue. As of December 31, 2007, we operated 139 funeral homes in 25 states and 32 cemeteries in 11 states. We primarily serve suburban markets and believe we are a market leader (first or second) in most of those markets. We provide funeral and cemetery services and products on both an “at-need” (time of death) and “preneed” (planned prior to death) basis.

Our operations are reported in two business segments:

- *Funeral Home Operations.* Funeral homes are principally service businesses that provide burial and cremation services and sell related merchandise, such as caskets and urns. Given the high fixed cost structure associated with funeral home operations, we believe the following are key factors affecting our profitability:
 - 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;
 - strong, entrepreneurial local leadership that capitalizes on local heritage and relationships;
 - controlling salary and merchandise costs; and
 - exercising pricing leverage related to our at-need business to increase average revenues per contract.
- *Cemetery Operations.* Cemeteries are primarily a sales business that provides interment rights (grave sites and mausoleums) and related merchandise, such as markers and memorials. Our cemetery operating results are impacted by the success of our sales organization because approximately 37.8% of our cemetery revenues during the year ended December 31, 2007 was generated from preneed sales of interment rights. We believe that changes in the level of consumer confidence (a measure of whether consumers will spend money on discretionary items) may impact the amount of such preneed sales. Cemetery revenues generated from at-need service and merchandise sales generally are subject to many of the same key profitability factors as in our funeral home business. Approximately 11.2% of our cemetery revenues during the year ended December 31, 2007 was attributable to investment earnings on trust funds and finance charges on installment contracts.

Our business strategy is based on strong, local leadership and entrepreneurial principles that we believe drive market share, revenue growth, and profitability in our local markets. Our Standards Operating Model, called “Being the Best,” was implemented at the beginning of 2004. We use the Standards Operating Model to measure the sustainable revenue growth and earning power of our portfolio of deathcare businesses. The standards based model emphasizes growing market share and improving long-term profitability by employing leadership and entrepreneurial principles that fit the nature of our local, personal service, high value business. This model also requires our local and corporate leaders to change our focus from short-term profitability to the drivers of success that create long-term profitability and value for our stockholders. Our operating model emphasizes:

- decentralized management of our local businesses;
- financial and operational standards based upon key drivers of success of our best businesses;

[Table of Contents](#)

- variable compensation that rewards our managers as if they were owners;
- finding, developing and retaining the best people in our industry; and
- information technology designed to support local businesses and corporate management decisions, measure performance of our businesses against our financial and operational standards, and ensure adherence to established internal control procedures.

Our business objectives include:

- growing market share, creating new heritage, producing consistent, modest revenue growth and sustainable increasing earnings and cash flow;
- continuing to improve our operating and financial performance by executing our Standards Operating Model;
- upgrading the leadership in our businesses, as necessary; and
- executing our Strategic Portfolio Optimization Model, a disciplined program that will guide our acquisition and disposition strategies, to change the sustainable earning power profile of our portfolio.

HISTORY

Carriage Services, Inc. was incorporated in Delaware in December of 1993. Prior to 2001, Carriage grew dramatically through acquisitions of funeral homes and cemeteries. A significant amount of debt was incurred in financing these acquisitions. Our business strategy during the four years ended December 31, 2004 focused on increasing operating cash flow and improving our financial condition by reducing debt to lower our interest expense and improve our credit profile. During that same period we initiated a process to identify underperforming businesses and, where appropriate, sold those businesses to reduce our debt. We sold 36 funeral homes and 12 cemeteries along with 20 parcels of excess real estate. We reduced our debt and contingent obligations by approximately \$87 million during the period January 1, 2001 through December 31, 2004. During January 2005, we refinanced our senior debt by issuing \$130 million of Senior Notes due in 2015. This refinancing represented a milestone. The refinancing was the culmination of the effort to reaccess the capital markets and to extend the maturities of our senior debt and to gain the flexibility to reinvest our cash flow in our core business. We used the net cash proceeds from the offering and our cash flow to grow our Company through selective acquisitions. During 2005, we acquired a funeral business consisting of two chapels in northern Florida, the first acquisition since 2002. During 2007, we completed seven acquisitions. See Note 5 to the Consolidated Financial Statements for acquisitions during 2007.

DEATH CARE INDUSTRY

Death care companies provide products and services to families in three principal areas: (i) ceremony and tribute, generally in the form of a funeral or memorial service; (ii) disposition of remains, either through burial or cremation; and (iii) memorialization, generally through monuments, markers or inscriptions. The death care industry in the United States is characterized by the following fundamental attributes (the statistics included in this report are based on public reports from financial research firms or public websites):

Death Rates

Death rates in the United States have been relatively stable on a long-term historical basis. The number of deaths in the United States increased at an annual rate of approximately 1% for the period from 1980 to 2000. Beginning in 2001, death rates have trended lower very slightly as the general population is living longer and because of low birth rates in the period from early 1930's to mid 1940's during the depression and World War II. The number of deaths per year in the United States is expected to increase from approximately 2.4 million in 2006 to 2.6 million in 2010 according to the United States Bureau of the Census. In addition, the segment of the United States population over 65 years of age is expected to increase by over 10% from approximately 36.7 million in 2005 to 40.2 million in 2010.

Cremation

In recent years, there has been a steady, gradual increase in the number of families in the United States that have chosen cremation as an alternative to traditional methods of burial. According to industry studies, cremations represented approximately 32% of the U.S. burial market in 2005. That number is expected to increase to 38% by 2010 and 51% by 2025. Cremation rates can vary significantly based upon geographic, religious and cultural traditions. Historically, direct cremation has been offered as a less costly alternative to a traditional burial. However, cremation is being increasingly accepted as part of a package of funeral services that includes memorials, merchandise and options for the interment of cremated remains.

Highly Fragmented Ownership

We understand that there are approximately 22,000 funeral homes and 10,500 cemeteries in the United States and that the domestic funeral service industry generates approximately \$15 billion of revenue annually. The largest public operators, in terms of revenue, of both funeral homes and cemeteries in the United States are Service Corporation International, StoneMor Partners L.P., Stewart Enterprises, Inc., and Carriage Services, Inc. We believe these three companies collectively represent approximately 20% of death care revenues in the United States. Independent businesses represent the remaining amount of industry revenue, accounting for an estimated 80% share. During most of the 1990s, there was a trend toward independent firms consolidating with public operators. However, few acquisitions of independents by the public companies have occurred since 1999 and there have been a number of independent entrants in local markets. As a result, the industry continues to be characterized by a large number of locally-owned, independent businesses. Service Corporation International acquired what was the second largest public company in the industry, Alderwoods Group in 2006. During 2007, we acquired three businesses from Service Corporation International and four independent businesses.

Heritage and Tradition

Death care businesses have traditionally been family-owned businesses that have built a local heritage and tradition through successive generations, providing a foundation for ongoing business opportunities from established client family relationships and related referrals. Given the sensitive nature of our business, we believe that relationships fostered at the local level build trust in the community and are a key driver of market share. While new entrants may enter any given market, the time and resources required to develop local heritage and tradition serve as important barriers to entry.

BUSINESS STRATEGY

Key elements of our overall business strategy include the following:

Implement Operating Initiatives. On January 1, 2004, we introduced our Standards Operating Model, a more decentralized and entrepreneurial financial operating model for our funeral homes. On January 1, 2006 we implemented a similar model to our cemetery business. These models are based on standards designed to grow market share and increase profitability developed from our best operations, along with an incentive compensation plan to reward business managers for successfully meeting or exceeding the standards. The model essentially eliminated the use of financial budgets. The operating model and standards, which we refer to as "Being the Best," focus on the key drivers of a successful 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 business. To date, the Standards Operating Model has driven significant changes in our organization, leadership and operating practices. Most importantly, the Standards Operating Model allowed us to measure the sustainable revenue growth and earning power of our portfolio

[Table of Contents](#)

of deathcare businesses, which then led to development of a Strategic Portfolio Optimization Model during 2006 that will guide our acquisition and disposition strategies in the future. Both models, when executed effectively, should drive longer term, sustainable increases in market share, revenue, earnings and free cash flow. The standards are not designed to produce maximum short term earnings because we do not believe such performance is sustainable without ultimately stressing the business, which often leads to declining market share, revenues and earnings.

Our managing partners participate in a variable bonus plan in which they earn a percentage of their business' earnings based upon the actual standards achieved. We believe our managing partners have the opportunity to be compensated at close to the same level as if they owned the business.

Presentation and Packaging of Services and Merchandise. We believe packaging funeral services and merchandise offers both simplicity and convenience for our client families. Well-conceived and thoughtful packages eliminate much of the effort and discomfort experienced by client families concerning matters about which they do not have much knowledge during a very stressful and emotional time. We also anticipate that our packaging strategy will result in increased revenue per cremation service over time as more families select packages that provide services and merchandise. The percentages of funeral services conducted by us in which cremation was chosen as the manner in which to dispose of remains was 34.4% for the year ended December 31, 2006 and 35.8% for the year ended December 31, 2007. For the year ended December 31, 2007, approximately 63.1% of the number of our total cremation services were direct cremations (where no viewing, visitation, or merchandise is involved, although a memorial service may be held) and 36.9% included additional services and merchandise.

Preneed Funeral Sales Program. We operate under a local, decentralized preneed sales strategy whereby each business location customizes its preneed program to its local needs. We emphasize insurance-funded contracts over trusted contracts in most markets, as insurance products allow us to earn commission income to improve our cash flow and offset a significant amount of the up-front costs associated with preneed sales. In addition, the cash flow and earnings from insurance contracts are more stable than traditional trust fund investments. In markets that depend on preneed sales for market share, we supplement the arrangements written by funeral directors with sales sourced by sales counselors and third party sellers.

Renewed Corporate Development Efforts. We believe that our capital structure positions us to pursue a strategy of disciplined growth, affording us the flexibility to redeploy our cash and cash flow toward selective acquisitions that meet our criteria. We expect to continue to improve our earning power as we invest in businesses that will contribute incremental revenues, earnings and cash flow. Our Strategic Portfolio Optimization Model is a primary driver of our acquisition strategy. We use strategic ranking criteria to assess acquisition candidates in order to optimize the sustainable earning power of our deathcare portfolio. As we execute this strategy, we will acquire larger, higher margin strategic businesses and sell smaller, lower margin non-strategic businesses.

Ideal candidates would be those that are demonstrated market leaders, have strong local management, have owners and family members whose objectives are aligned with ours, and have field-level operating margins consistent with our best performing properties. In our quest to find ideal candidates, we have analyzed and projected key statistics in the deathcare industry and believe the following will be true by 2015:

- The number of national deaths will begin a long-term rise as the death rate among the baby boomer generation accelerates, notwithstanding a longer life expectancy.
- The aging baby boomers will possess sufficient wealth and the financial flexibility to migrate to attractive retirement and part time second career areas primarily in the southern and western states and other select markets.
- The general population of the United States will continue to grow and migrate to attractive urban and suburban centers in the southern and western states.
- Cremation rates will continue to increase and migrate eastward. The accelerating cremation rate will have a significant impact on the revenue base of more traditional deathcare businesses in the Central and Eastern regions of the United States and a lesser impact on the already high cremation states in the West.

With the above considerations in mind, our vision over the next ten years is to change the profile of our practice to be heavily weighted in about 10-15 major markets that have an especially attractive demographic profile and where over time, we could acquire or build up operations in each of these markets by doing one to three thousand calls annually. We believe there are large enough markets for us to increase our presence in existing markets by acquisition or enter a new market with a substantial acquisition while leveraging our strong local franchise brands and entrepreneurial leadership. We will use our Standards Operating Model to evaluate acquisition candidates to ensure they can be readily integrated into our portfolio.

OUR STRENGTHS

Market Leader in Our Suburban and Rural Markets. Our operations are located in principally suburban and rural markets, where we primarily compete with smaller, independent operators. Most of our suburban markets have populations of 100,000 or more. In over 70% of our funeral home markets, we believe that we are either first or second in local market share.

Partnership Culture. Our funeral homes and cemeteries are managed by individuals that we refer to as Managing Partners, with extensive death care experience, often within their local markets. Our Managing Partners have responsibility for day-to-day operations but are required to follow operating and financial standards that are custom designed for each of four groupings using size of business and cremation rate as specific grouping criteria. This strategy allows each local business to maintain its unique identity within its local market and to capitalize on its reputation and heritage while our senior management maintains supervisory controls and provides support services from our corporate headquarters. We believe our culture is very attractive to owners of premier independent businesses that fit our profile of suitable acquisition candidates.

Flexible Capital Structure. In January 2005, we completed our \$130 million senior debt offering. We used the net proceeds to pay off the existing senior debt that had near term maturities and accrued interest on our TIDES, described below. This transaction eliminated all near-term debt maturity issues. We believe that our capital structure provides us with financial flexibility, which allows us to invest in our growth. Currently, we have four primary components in our capital structure:

- the \$130 million senior notes which have a 2015 maturity;
- a revolving credit facility, described under the heading “Liquidity and Capital Resources” in Item 7;
- our convertible junior subordinated debenture payable to our affiliate trust, which has the ability to defer payments of interest, and a 2029 maturity (our TIDES); and
- our common stock.

Stable Cash Flow. Since 2000, we have demonstrated the ability to generate stable cash flow. Prior to 2005, our primary use of cash flow was to repay debt. Free cash flow (cash flow from operations less maintenance capital expenditures) for 2007 totaled \$11.7 million. We intend to use cash flow to fund a selective growth strategy. Our growth strategy is the primary way we expect to increase stockholder value. We will reassess our capital allocation strategy annually, but at this point we believe that our financial goals will best be achieved by continuing to improve the operating and financial performance of our existing portfolio while selectively investing our free cash flow in growth opportunities that generate a return on invested capital in excess of our weighted average cost of capital.

Strong Field-Level Operating Margins. We believe that our field-level operating margins are among the highest reported by the public companies in the death care industry and that this performance is a testament to the success of our business strategies. These strong margins and the ability to control costs are important advantages in a business such as ours that is characterized by a high fixed-cost structure. We will continue to seek ways to improve our financial performance, and we believe that our standards-based operating model will continue to yield long-term improvement in our financial results.

Effective Management of Funeral Preneed Sales. We believe our local, decentralized strategy allows us to adapt our preneed sales selectively to best address the competitive situation in our markets. In highly competitive markets, we execute a more aggressive preneed sales program. In less competitive markets where we have a strong market position, we deploy a more passive preneed sales program. In certain of our markets, we do not deploy a formal preneed program. This approach allows us to target the investment in preneed sales to markets where we have the opportunity to reinforce our market share. Since approximately 80% of our revenues are generated from at-need sales, we retain significant pricing leverage in our funeral business.

Integrated Information Systems. We have implemented information systems to support local business decisions and to monitor performance of our businesses compared to financial and performance standards. All of our funeral homes and cemeteries are connected to our corporate headquarters, which allows us to monitor and assess critical operating and financial data in order to analyze the performance of individual locations on a timely basis. Furthermore, our information system infrastructure provides senior management with a critical tool for monitoring and adhering to our established internal controls, which is critical given our decentralized model and the sensitive nature of our business operations.

Proven Management Team. Our management team, headed by our founder and Chief Executive Officer (CEO) Mel Payne, is characterized by a dynamic culture that reacts quickly and proactively to address changing market conditions and emerging trends. We believe this culture has been critical to our recent successful efforts and will provide an important advantage as the death care industry evolves. We are committed to continue operating an efficient corporate organization and strengthening our corporate and local business leadership. We believe that our Being the Best Standards Operating Model will ensure this commitment at all levels of the

organization. At mid-year 2006 we reorganized our funeral and cemetery divisions into three Regions, each headed by a Regional Partner. This change promotes more cooperation between our funeral and cemetery operations and supports the goal of market-share and volume growth in our most significant markets. The three Regional Partners report to our CEO.

OPERATIONS

We conduct our funeral and cemetery operations only in the United States. Our operations are reported in two segments: funeral operations and cemetery operations. Information for each of our segments is presented below and in our financial statements set forth herein.

Funeral Home Operations

At December 31, 2007, we operated 139 funeral homes in 25 states. Funeral home revenues currently account for approximately 75% of our total revenues. The funeral home operations are managed by a team of experienced death care industry professionals and selected region-level individuals with substantial management experience in our industry. See Note 22 to the Consolidated Financial Statements for the year ended December 31, 2007, for segment data related to funeral home operations.

Our funeral homes offer a complete range of services to meet a family's funeral needs, including consultation, the removal and preparation of remains, the sale of caskets and related funeral merchandise, the use of funeral home facilities for visitation and worship, and transportation services. Most of our funeral homes have a non-denominational chapel on the premises, which permits family visitation and religious services to take place at one location and thereby reduces our transportation costs and inconvenience to the family.

Funeral homes are principally a service business that provides burial and cremation services and sells related merchandise, such as caskets and urns. Given the high fixed cost structure associated with funeral home operations, we believe the following are key factors affecting our profitability:

- demographic trends in terms of population growth and average age, which impact death rates and number of deaths;
- leading market share positions;
- strong, entrepreneurial local leadership that capitalizes on local heritage and relationships;
- controlling salary and merchandise costs; and
- exercising pricing leverage related to our at-need business to increase average revenues per contract.

Cemetery Operations

As of December 31, 2007, we operated 32 cemeteries in 11 states. The cemetery operations are managed by a team of experienced death care industry and sales professionals. Cemetery revenues currently account for approximately 25% of our total revenues. See Note 22 to the Consolidated Financial Statements for the year ended December 31, 2007, for segment data related to cemetery operations.

Our cemetery products and services include interment services, the rights to interment in cemetery sites (including grave sites, mausoleum crypts and niches) and related cemetery merchandise such as memorials and vaults. Cemetery operations generate revenues through sales of interment rights and memorials, installation fees, fees for interment and cremation services, finance charges from installment sales contracts and investment income from preneed cemetery merchandise and perpetual care trusts.

Our cemetery operating results are impacted by the success of our sales organization because 38% of our cemetery revenues was generated from preneed sales of interment rights during the year ended December 31, 2007. An additional 15% of our 2007 cemetery revenues was from deliveries of merchandise and services previously sold on preneed contracts. We believe that changes in the level of consumer confidence (a measure of whether consumers will spend money on discretionary items) impact the amount of cemetery revenues. Cemetery revenues generated from at-need services and merchandise sales generally are subject to many of the same key profitability factors as in our funeral home business. Approximately 13% of our cemetery revenues was attributable to investment earnings on trust funds and finance charges on installment contracts during the year ended December 31, 2007. Changes in the capital markets and interest rates affect this component of our cemetery revenues.

Preneed Programs

In addition to sales of funeral merchandise and services, cemetery interment rights and cemetery merchandise and services at the time of need, we also market funeral and cemetery services and products on a preneed basis. Preneed funeral or cemetery contracts enable families to establish, in advance, the type of service to be performed, the products to be used and the cost of such products and services. Preneed contracts permit families to eliminate issues of making death care plans at the time of need and allow input from other family members before the death occurs.

Preneed funeral contracts are usually paid on an installment basis. The performance of preneed funeral contracts is usually secured by placing the funds collected in trust for the benefit of the customer or by the purchase of a life insurance policy, the proceeds of which will pay for such services at the time of need. Insurance policies, intended to fund preneed funeral contracts, cover the original contract price and generally include an element of growth (earnings) designed to offset future inflationary cost increases. Revenue from preneed funeral contracts, along with accumulated earnings, are not recognized until the time the funeral service is performed. The commission income is recognized as revenue when the period of refund expires (generally one year), which helps us defray the costs we incur to originate the preneed contract (primarily commissions we pay to our sales counselors). Additionally, we generally earn a commission from the insurance company from the sale of insurance-funded policies. Prior to 2005, the direct marketing commissions and costs incurred from the sale of preneed funeral contracts were deferred and amortized on an actuarial method to match the expected maturity of the preneed contracts. Effective January 1, 2005, we changed our method for accounting for deferred obtaining costs and began expensing all costs as incurred. See Note 3 to the Consolidated Financial Statements for the year ended December 31, 2007, for more detailed discussion of this accounting change.

In addition to preneed funeral contracts, we also offer “preplanned” funeral arrangements whereby a client determines in advance substantially all of the details of a funeral service without any financial commitment or other obligation on the part of the client until the actual time of need. Preplanned funeral arrangements permit a family to avoid issues of making death care plans at the time of need and enable a funeral home to establish relationships with a client that may eventually lead to an at-need sale.

Preneed sales of cemetery interment rights are usually financed through interest-bearing installment sales contracts, generally with terms of up to five years. In substantially all cases, we receive an initial down payment at the time the contract is signed. The interest rates generally range between 12% and 14%. Preneed sales of cemetery interment rights are generally recorded as revenue when 10% of the contract amount related to the interment right has been collected. Merchandise and services may similarly be sold on an installment basis, but revenue is recorded when delivery has occurred. Allowances for customer cancellations and refunds are recorded at the date that the contract is executed and periodically evaluated thereafter based upon historical experience.

We sold 4,998 and 5,161 preneed funeral contracts during the years ended December 31, 2006 and 2007, respectively. At December 31, 2007, we had a backlog of 68,909 preneed funeral contracts to be delivered in the future. Approximately 21% of the funeral revenues recognized during each of the last three years and during the twelve months ended December 31, 2007 originated through preneed contracts. Cemetery revenues that originated from preneed contracts represented approximately 52% of our net cemetery revenues for both 2006 and 2007.

As of December 31, 2007, we employed a staff of 168 advance-planning and family service representatives for the sale of preneed products and services.

TRUST FUNDS AND INSURANCE CONTRACTS

We have established a variety of trusts in connection with funeral home and cemetery operations as required under applicable state law. Such trusts include (i) preneed funeral trusts; (ii) preneed cemetery merchandise and service trusts; and (iii) perpetual care trusts. These trusts are typically administered by independent financial institutions selected by the Company. Independent financial advisors are also used for investment management and advisory services.

Preneed funeral sales generally require deposits to a trust or purchase of a third-party insurance product. Trust fund income earned and the receipt and recognition of any insurance benefits are deferred until the service is performed, while trust fund holdings and deferred revenue are reflected currently on our balance sheet. In most states, we are not permitted to withdraw principal or investment income from such trusts until the funeral service is performed. Some states, however, allow for the retention of a percentage (generally 10%) of the receipts to offset any administrative and selling expenses. The aggregate balance of our preneed funeral contracts held in trust, insurance contracts and receivables from customers was approximately \$280.0 million as of December 31, 2007.

We are generally required under applicable state laws to deposit a specified amount (which varies from state to state, generally 50% to 100% of selling price) into a merchandise and service trust fund for cemetery merchandise and services preneed sales. The related trust fund income earned is recognized when the related merchandise and services are delivered. We are generally permitted to

withdraw the trust principal and accrued income when the merchandise is actually purchased, when the service is provided or when the contract is cancelled. Cemetery merchandise and service trust fund balances, in the aggregate, totaled approximately \$61.1 million as of December 31, 2007.

In most states, regulations require a portion (generally 10%) of the sale amount of cemetery property and memorials to be placed in a perpetual care trust. The income from these perpetual care trusts provides a portion of the funds necessary to maintain cemetery property and memorials in perpetuity. This trust fund income is recognized, as earned, in cemetery revenues. While we are entitled to withdraw the income from perpetual care trusts to provide for maintenance of cemetery property and memorials, we are restricted from withdrawing any of the principal balances of the trust fund. Perpetual care trust balances totaled approximately \$37.2 million at December 31, 2007.

For additional information with respect to our trusts, see Notes 9, 10, 11 and 12 to the Consolidated Financial Statements for the year ended December 31, 2007.

COMPETITION

The operating environment in the death care industry has been highly competitive. Publicly traded companies operating in the United States are Service Corporation International, Stewart Enterprises, Inc, Keystone North America, Inc. and StoneMor Partners L.P. In addition, a number of smaller, non-public companies have been active in acquiring and operating funeral homes and cemeteries.

Our funeral home and cemetery operations usually face competition in the markets that they serve. Our primary competition in most of our markets is from local independent operators. We have observed new start-up competition in certain areas of the country, which in any one market may have impacted our profitability because of the high fixed cost nature of funeral homes. Market share for funeral homes and cemeteries is largely a function of reputation and heritage, although competitive pricing, professional service and attractive, well-maintained and conveniently located facilities are also important. Because of the importance of reputation and heritage, market share increases are usually gained over a long period of time. The sale of preneed funeral services and cemetery property has increasingly been used by many companies as a marketing tool to build market share.

There has been increasing competition from providers specializing in specific services, such as cremations, who offer minimal service and low-end pricing. We also face competition from companies that market products and related merchandise over the Internet and non-traditional casket stores in certain markets. These competitors have been successful in capturing a portion of the low-end market and product sales.

REGULATION

Our operations are subject to regulations, supervision and licensing under numerous foreign, federal, state and local laws, ordinances and regulations, including extensive regulations concerning trust funds, preneed sales of funeral and cemetery products and services and various other aspects of our business. We believe that we comply in all material respects with the provisions of these laws, ordinances and regulations. We operate in the United States under the Federal Trade Commission (FTC) comprehensive trade regulation rule for the funeral industry. The rule contains requirements for funeral industry practices, including extensive price and other affirmative disclosures and imposes mandatory itemization of funeral goods and services.

We are subject to the requirements of the federal Occupational Safety and Health Act ("OSHA") and comparable state statutes. The OSHA hazard communication standard, the United States Environmental Protection Agency community right-to-know regulations under Title III of the federal Superfund Amendment and Reauthorization Act and similar state statutes require us to organize information about hazardous materials used or produced in our operations. Certain of this information must be provided to employees, state and local governmental authorities and local citizens.

Our operations, including our preneed sales activities and the management and administration of preneed trust funds, are also subject to regulation, supervision and licensing under state laws and regulations. We believe that we are in substantial compliance with all such laws and regulations.

EMPLOYEES

As of December 31, 2007, we and our subsidiaries employed 1,776 employees, of whom 872 were full-time and 904 part-time. All of our funeral directors and embalmers possess licenses required by applicable regulatory agencies. We believe that our relationship with our employees is good. None of our employees are represented by unions.

AVAILABLE INFORMATION

We file annual, quarterly and other reports, and any amendments to those reports, and information with the United States Securities and Exchange Commission (“SEC”). You may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain additional information about the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including us.

Our website address is www.carriageservices.com. Available on this website under “Investor Relations-Investor Relations Menu – SEC Filings,” free of charge, are Carriage’s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, insider reports on Forms 3, 4 and 5 filed on behalf of directors and officers and amendments to those reports as soon as reasonably practicable after such materials are electronically filed with or furnished to the United States Securities and Exchange Commission (“SEC”).

Also posted on our website, and available in print upon request, are charters for the Company’s Audit Committee, Compensation Committee and Corporate Governance Committee. Copies of the Code of Business Conduct and Ethics and the Corporate Governance Guidelines are also posted on the Company’s website under the “Corporate Governance” section. Within the time period required by the SEC and the New York Stock Exchange, Inc., we will post on our website any modifications to the Codes and any waivers applicable to senior officers as defined in the applicable Code, as required by the Sarbanes-Oxley Act of 2002.

ITEM 1A. RISK FACTORS

RISKS RELATED TO OUR BUSINESS

Marketing and sales activities by existing and new competitors could cause us to lose market share and lead to lower revenues and margins.

We face competition in all of our markets. Most of our competitors are independently owned, and some are relatively recent market entrants. Certain of the recent entrants are individuals who were formerly employed by us or by our competitors and have relationships and name recognition within our markets. As a group, independent competitors tend to be aggressive in distinguishing themselves by their independent ownership, and they promote their independence through advertising, direct mailings and personal contact. Increasing pressures from new market entrants and continued advertising and marketing by competitors in local markets could cause us to lose market share and revenues. In addition, competitors may change the types or mix of products or services offered. These changes may attract customers, causing us to lose market share and revenue as well as to incur costs in response to competition to vary the types or mix of products or services offered by us.

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

Declines in preneed sales would reduce our backlog and revenue and could reduce our future market share. On the other hand, a significant increase in preneed sales can have a negative impact on cash flow as a result of commissions and other costs incurred without corresponding revenues.

As we have localized our preneed sales strategies, we are continuing to refine the mix of service and product offerings in both our funeral and cemetery segments, including changes in our sales commission and incentive structure. These changes could cause us to experience declines in preneed sales in the short-run. In addition, economic conditions at the local or national level could cause declines in preneed sales either as a result of less discretionary income or lower consumer confidence. Declines in preneed cemetery property sales would reduce current revenue, and declines in other preneed sales would reduce our backlog and future revenue and could reduce future market share.

Preneed sales of cemetery property and funeral and cemetery merchandise and services are generally cash flow negative initially, primarily due to the commissions paid on the sale, the portion of the sales proceeds required to be placed into trust or escrow and the terms of the particular contract such as the size of the down payment required and the length of the contract. As a result, preneed sales reduce cash flow available for other activities, and, to the extent preneed activities are increased, cash flow will be further reduced.

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 margins.

We have historically experienced price competition primarily from independent funeral home and cemetery operators, and from monument dealers, casket retailers, low-cost funeral providers and other non-traditional providers of services or products. New

market entrants tend to attempt to build market share by offering lower cost alternatives. In the past, this price competition has resulted in our losing market share in some markets. In other markets, we have had to reduce prices thereby reducing profit margins in order to retain or recapture market share. Increased price competition in the future could further reduce revenues, profit margins and our backlog.

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.

There is no assurance that we will be able to continue to identify candidates that meet our criteria or that we will be able to reach terms with identified candidates for transactions that are acceptable to us. We intend to apply standards established under our Strategic Portfolio Optimization Model to evaluate acquisition candidates, and there is no assurance that we will continue to be successful in doing so or that we will find attractive candidates that satisfy these standards.

Increased or unanticipated costs, such as insurance, taxes or litigation, may have a negative impact on our earnings and cash flow.

We have experienced material increases in certain costs during the previous years, such as insurance, taxes or legal fees, which result from external factors difficult to estimate. These costs may impair our ability to achieve earnings growth in excess of revenue growth. Our 2008 plan assumes that we will be successful in increasing earnings at a rate that is greater than revenue growth. We can give no assurance that we will be successful in achieving such increases.

Improved performance in our funeral and cemetery segments is highly dependent upon successful execution of our Standards Operating Model.

We have implemented our standards-based operating model to improve and better measure performance in our funeral and cemetery operations. We developed standards according to criteria, each with a different weighting, designed around market share, people, and operational and financial metrics. We also incentivise our location managing partners by giving them the opportunity to earn a fixed percentage of the field-level earnings before interest, taxes, depreciation and amortization based upon the number and weighting of the standards achieved. Our expectation is that, over time, the Standards Operating Model will result in our maintaining or improving field-level margins, market share, customer satisfaction and overall financial performance, but there is no assurance that these goals will be met. We have learned that success using the model is highly dependent on having the right leader in the business.

Our smaller businesses are typically dependent upon one or a few key employees for success.

Death care businesses have built local heritage and tradition through successive generations, providing a foundation for ongoing business opportunities from established client family relationships and related referrals. We believe these relationships build trust in the community and are a key driver to market share. Our businesses, which tend to serve small local markets, usually have one or a few key employees that drive our relationships. We can give no assurance that we can retain these employees or that these relationships will drive market share.

Earnings from and principal of trust funds and insurance contracts could be reduced by changes in financial markets and the mix of securities owned.

Earnings and investment gains and losses on trust funds and insurance contracts are affected by financial market conditions and the mix of fixed-income and equity securities that we choose to maintain in the funds. During 2004 and 2005, we revised the mix of investments within the cemetery trusts according to our new asset allocation model in an effort to increase earnings and lower volatility. We made similar changes in some of the funeral trusts in 2006. We may not choose the optimal mix for any particular market condition. Declines in earnings from perpetual care trust funds would cause a decline in current revenues, while declines in earnings from other trust funds could cause a decline in future cash flows and revenues.

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

The terms of our credit facility and the indenture governing the Senior Notes may limit our ability and the ability of our subsidiaries to, among other things:

- incur additional debt;
- pay dividends or make distributions or redeem or repurchase stock;
- make investments;

[Table of Contents](#)

- grant liens;
- make capital expenditures;
- enter into transactions with affiliates;
- enter into sale-leaseback transactions;
- sell assets; and
- acquire the assets of, or merge or consolidate with, other companies.

Our credit facility also requires us to maintain certain financial ratios. Complying with these restrictive covenants and financial ratios, as well as those that may be contained in any future debt agreements, may impair our ability to finance our future operations or capital needs or to take advantage of other favorable business opportunities. Our ability to comply with these restrictive covenants and financial ratios will depend on our future performance, which may be affected by events beyond our control. Our failure to comply with any of these covenants or restrictions when they apply will result in a default under the particular debt instrument, which could permit acceleration of the debt under that instrument and, in some cases, the acceleration of debt under other instruments that contain cross-default or cross-acceleration provisions. In the case of an event of default, or in the event of a cross-default or cross-acceleration, we may not have sufficient funds available to make the required payments under our debt instruments. If we are unable to repay amounts owed under the terms of our amended senior secured credit facility, the lenders thereunder may be entitled to sell certain of our funeral assets to satisfy our obligations under the agreement.

RISKS RELATED TO THE DEATH CARE INDUSTRY

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

Declines in the number of deaths could cause at-need sales of funeral and cemetery services, property and merchandise to decline, which could decrease revenues. Although the United States Bureau of the Census estimates that the number of deaths in the United States will increase through 2010, longer life spans could reduce the rate of deaths. In addition, changes in the number of deaths can vary among local markets and from quarter to quarter, and variations in the number of deaths in our markets or from quarter to quarter are not predictable. These variations may cause our revenues to fluctuate and our results of operations to lack predictability.

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 minimal revenues for cemetery operations and lower funeral revenues.

Our traditional cemetery and funeral service operations face competition from the increasing number of cremations in the United States. Industry studies indicate that the percentage of cremations has steadily increased and that cremations will represent approximately 39% of the U.S. burial market by the year 2010, compared to approximately 32% in 2005. The trend toward cremation could cause cemeteries and traditional funeral homes to lose market share and revenues to firms specializing in cremations. In addition, direct cremations (with no funeral service, casket, urn, mausoleum niche, columbarium niche or burial) produce no revenues for cemetery operations and lower revenues than traditional funerals and, when delivered at a traditional funeral home, produce lower profit margins as well.

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

Future market share, revenues and profits will depend in part on our ability to anticipate, identify and respond to changing consumer preferences. In past years, we have implemented new product and service strategies based on results of customer surveys that we conduct on a continuous basis. However, we may not correctly anticipate or identify trends in consumer preferences, or we may identify them later than our competitors do. In addition, any strategies we may implement to address these trends may prove incorrect or ineffective.

Because the funeral and cemetery businesses are high fixed-cost businesses, changes in revenue can have a disproportionately large effect on cash flow and profits.

Companies in the funeral home and cemetery business must incur many of the costs of operating and maintaining facilities, land and equipment regardless of the level of sales in any given period. For example, we must pay salaries, utilities, property taxes and

[Table of Contents](#)

maintenance costs on funeral homes and maintain the grounds of cemeteries regardless of the number of funeral services or interments performed. Because we cannot decrease these costs significantly or rapidly when we experience declines in sales, declines in sales can cause margins, profits and cash flow to decline at a greater rate than the decline in revenues.

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

The death care industry is subject to extensive regulation and licensing requirements under federal, state and local laws. For example, the funeral home industry is regulated by the Federal Trade Commission, which requires funeral homes to take actions designed to protect consumers. State laws impose licensing requirements and regulate preneed sales. Embalming and cremation facilities are subject to stringent environmental and health regulations. Compliance with these regulations is burdensome, and we are always at risk of not complying with the regulations or facing costly and burdensome investigations from regulatory authorities.

In addition, from time to time, governments and agencies propose to amend or add regulations, which could increase costs or decrease cash flows. For example, federal, state, local and other regulatory agencies have considered and may enact additional legislation or regulations that could affect the death care industry. Several states and regulatory agencies have considered or are considering regulations that could require more liberal refund and cancellation policies for preneed sales of products and services, limit or eliminate our ability to use surety bonding, increase trust requirements and prohibit the common ownership of funeral homes and cemeteries in the same market. If adopted by the regulatory authorities of the jurisdictions in which we operate, these and other possible proposals could have a material adverse effect on us, our financial condition, our results of operations and our future prospects. For additional information regarding the regulation of the death care industry, see “Business — Regulation”.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

At December 31, 2007, we operated 139 funeral homes in 25 states and 32 cemeteries in 11 states. We own the real estate and buildings for 83% of our funeral homes and leases facilities for the remaining 17%. We own 27 cemeteries and operate five cemeteries under long-term contracts with municipalities and non-profit organizations at December 31, 2007. Eleven funeral homes are operated in combination with cemeteries as these locations are physically located on the same property or very close proximity and under same management. The 32 cemeteries operated by us have an inventory of unsold developed lots totaling approximately 114,000 and 118,000 at December 31, 2006 and 2007, respectively. In addition, approximately 496 acres are available for future development. We anticipate having a sufficient inventory of lots to maintain our property sales for the foreseeable future. The specialized nature of our business requires that our facilities be well-maintained. Management believes this standard is met.

[Table of Contents](#)

The following table sets forth certain information as of December 31, 2007, regarding Carriage's properties used by the funeral homes segment and by the cemeteries segment identified by state:

State	Number of Funeral Homes		Number of Cemeteries	
	Owned	Leased(1)	Owned	Managed
California	21	2	4	0
Connecticut	6	2	0	0
Florida	6	3	6	3
Georgia	3	0	0	0
Idaho	5	1	3	0
Illinois	1	4	1	0
Kansas	7	0	0	0
Kentucky	10	3	1	0
Maryland	1	0	0	0
Massachusetts	12	0	0	0
Michigan	3	0	0	0
Montana	1	0	0	0
Nevada	2	0	2	1
New Jersey	4	1	0	0
New Mexico	1	0	0	0
New York	1	0	0	0
North Carolina	1	2	1	0
Ohio	4	2	0	1
Oklahoma	1	0	1	0
Rhode Island	4	0	0	0
Tennessee	3	0	0	0
Texas	13	1	7	0
Virginia	3	1	1	0
Washington	1	1	0	0
West Virginia	1	1	0	0
Total	<u>115</u>	<u>24</u>	<u>27</u>	<u>5</u>

(1) The leases, with respect to these funeral homes, have remaining terms ranging from one to seven years, and, generally, we have the right to renew past the initial terms and a right of first refusal on any proposed sale of the property where these funeral homes are located.

Our corporate headquarters occupy approximately 37,000 square feet of leased office space in Houston, Texas. At December 31, 2007, we operated 590 vehicles, of which 585 are owned and 5 are leased.

ITEM 3. LEGAL PROCEEDINGS

We 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. Information regarding litigation is set forth in Part II, Item 8. Financial Statements and Supplementary Data, Note 16 of this Form 10-K.

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

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of our stockholders during the fourth quarter of 2007.

PART II**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our Common Stock is traded on the New York Stock Exchange under the symbol "CSV". The following table presents the quarterly high and low sale prices as reported by the New York Stock Exchange:

	High	Low
2007		
First Quarter	\$ 8.37	\$5.04
Second Quarter	\$ 8.93	\$7.50
Third Quarter	\$ 9.42	\$7.65
Fourth Quarter	\$11.09	\$8.12
2006		
First Quarter	\$ 5.25	\$4.60
Second Quarter	\$ 5.16	\$4.40
Third Quarter	\$ 4.94	\$4.12
Fourth Quarter	\$ 5.19	\$4.61

As of February 29, 2008, there were 19,260,820 shares of our Common Stock outstanding and the closing price as reported by the New York Stock Exchange was \$7.90 per share. The Common Stock shares outstanding are held by approximately 255 stockholders of record. Each share is entitled to one vote on matters requiring the vote of stockholders. We believe there are approximately 5,000 beneficial owners of the Common Stock.

We have never paid a cash dividend on our Common Stock. We currently intend to retain earnings to fund the growth and development of our business. Any future change in our policy will be made at the discretion of our Board of Directors in light of our financial condition, capital requirements, earnings prospects and any limitations imposed by lenders or investors, as well as other factors the Board of Directors may deem relevant.

We have a compensation policy for fees paid to our directors under which the directors may choose to receive their fees either in the form of cash or equity based on the fair market value of our common stock calculated at the closing price published by the New York Stock Exchange on the date the fees are earned. Prior to May 2006, the shares issued to directors were unregistered. In connection with our Annual Meeting of Stockholders in May 2006, the stockholders approved our 2006 Long Term Incentive Plan and we registered the shares available for future issuance for this compensation policy and other corporate purposes. We issued 3,003 unregistered shares of common stock to directors in lieu of payment in cash for their fees for the year ended December 31, 2006, the value of which was charged to operations. No underwriter was used in connection with these issuances. We relied on the Section 4(2) exemption from the registration requirements of the Securities Act of 1933, as amended.

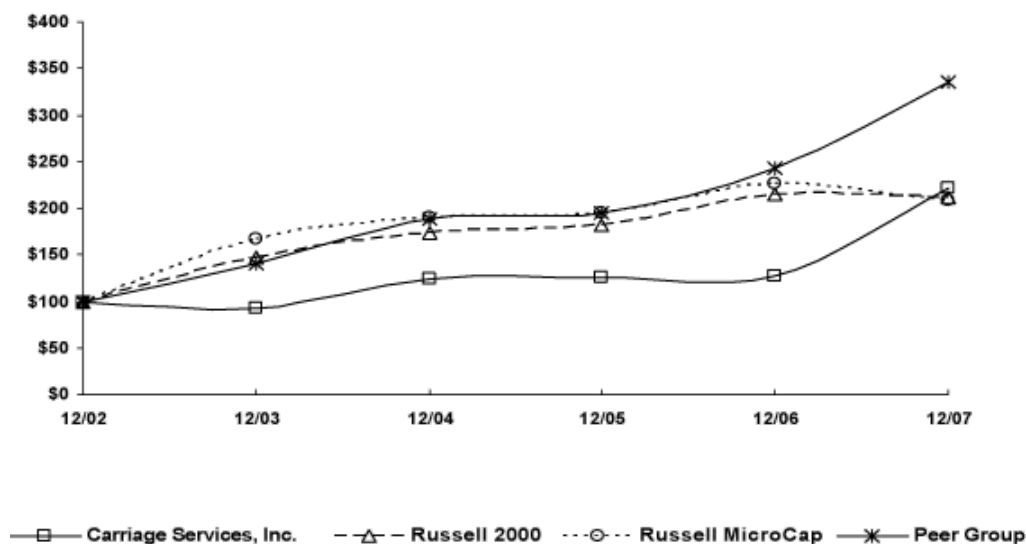
We did not repurchase any of our equity securities during the fourth quarter of the year ended December 31, 2007.

[Table of Contents](#)

The graph below matches the cumulative 5-year total return of holders of Carriage Services, Inc.'s common stock with the cumulative total returns of the Russell 2000 index, the Russell MicroCap index and a customized peer group of three companies that includes: Service Corporation International, Stewart Enterprises Inc. and StoneMor Partners L.P. The graph assumes that the value of the investment in the company's common stock, in each index, and in the peer group (including reinvestment of dividends) was \$100 on 12/31/2002 and tracks it through 12/31/2007.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Carriage Services, Inc., The Russell 2000 Index,
The Russell MicroCap Index And A Peer Group



* \$100 invested on 12/31/02 in stock or index-including reinvestment of dividends.

Fiscal year ending December 31.

	12/02	12/03	12/04	12/05	12/06	12/07
Carriage Services, Inc.	100.00	92.96	124.12	125.63	127.89	221.11
Russell 2000	100.00	147.25	174.24	182.18	215.64	212.26
Russell MicroCap	100.00	166.36	189.89	194.76	226.98	208.82
Peer Group	100.00	139.86	187.63	194.38	243.59	335.65

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

PEER GROUP

Service Corporation International

Stewart Enterprises Inc.

StoneMor Partners L.P.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth selected consolidated financial information for us that has been derived from the audited Consolidated Financial Statements of Carriage Services, Inc. as of and for each of the years ended December 31, 2003, 2004, 2005, 2006 and 2007. These historical results are neither indicative of our future performance, nor necessarily comparable as a result of a change in accounting methods discussed below.

We adopted FASB Interpretation No. 46, as revised (“FIN 46R”), “Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) No. 51”, as of March 31, 2004. The adoption of FIN 46R resulted in the consolidation of funeral and cemetery merchandise and service, and perpetual care trusts in our consolidated balance sheet at fair value. We do not consolidate certain funeral trusts for which we do not recognize a majority of their expected losses and, therefore, are not considered a primary beneficiary of these funeral trusts under FIN 46R. The adoption of FIN 46R also resulted in the deconsolidation of Carriage Services Capital Trust, the issuer of TIDES preferred securities. We now report as a liability the junior subordinated debenture payable to the Trust. Amounts and balances prior to March 31, 2004 have not been restated to reflect the adoption of FIN 46R.

We changed our method of accounting for preneed selling costs, which are direct costs incurred for the origination of prearranged funeral and cemetery service and merchandise sales contracts, effective January 1, 2005. The change affects the comparability of the operating results in the following table. 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 new accounting method, the commissions and other direct selling costs, which are current obligations and use operating cash flow, are expensed as incurred. Our results of operations for the years ended December 31, 2005, 2006 and 2007 are reported on the basis of our changed method, but the periods prior to 2005 are reported using the prior accounting method. See Note 3 of Notes to Consolidated Financial Statements for the year ended December 31, 2007.

Effective January 1, 2006, we adopted Statement Financial Accounting Standards No. 123 (Revised), “Share-Based Payment” (“FAS No. 123R”), which requires, among other things, entities to recognize in the income statement the grant-date fair value of stock options and other stock-based awards over the service periods the awards are expected to vest. Pursuant to the provisions of FAS No. 123R, we applied the modified-prospective transition method. Under this method, the fair value provision of FAS No. 123R is applied to new employee stock-based awards granted after December 31, 2005. Measurement and recognition of compensation cost for unvested awards at December 31, 2005, granted prior to the adoption of FAS No. 123R, are recognized under the provisions of FAS No. 123, “Accounting for Stock-Based Compensation” (“FAS No. 123”), after adjustments for estimated forfeiture. FAS No. 123R no longer permits pro-forma disclosure for income statement periods after December 31, 2005 and compensation expense is recognized for all stock-based awards based on grant-date fair value. Our results of operations for the years ended December 31, 2006 and 2007 are reported on the basis of our changed method, but the periods prior to 2006 are reported using the prior accounting method. See Note 1 of Notes to Consolidated Financial Statements for the year ended December 31, 2007.

You should read this historical financial data together with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in this report and our Consolidated Financial Statements and notes thereto included elsewhere in this report.

[Table of Contents](#)

	Year ended December 31,				
	2003	2004	2005	2006	2007
INCOME STATEMENT DATA:					
Revenues:					
Funeral	\$ 107,542	\$ 108,102	\$ 110,882	\$ 114,187	\$ 124,808
Cemetery	33,059	36,115	37,555	36,159	43,016
Total revenues	<u>140,601</u>	<u>144,217</u>	<u>148,437</u>	<u>150,346</u>	<u>167,824</u>
Gross profit:					
Funeral	27,826	28,387	28,976	30,685	36,446
Cemetery	8,128	8,578	6,525	3,943	9,354
Total gross profit	<u>35,954</u>	<u>36,965</u>	<u>35,501</u>	<u>34,628</u>	<u>45,800</u>
General and administrative expenses	9,964	10,113	12,383	12,022	16,015
Other charges (income)	432	495	(822)	—	—
Operating income	<u>25,558</u>	<u>26,357</u>	<u>23,940</u>	<u>22,606</u>	<u>29,785</u>
Interest expense	(17,626)	(16,896)	(18,587)	(18,508)	(18,344)
Additional interest and other costs of senior debt refinancing	—	—	(6,933)	—	—
Interest and other income (expense)	657	940	(73)	1,921	1,152
Income (loss) before income taxes	8,589	10,401	(1,653)	6,019	12,593
(Provision) benefit for income taxes	(3,047)	(80)	532	(2,305)	(5,068)
Net income (loss) from continuing operations	<u>5,542</u>	<u>10,321</u>	<u>(1,121)</u>	<u>3,714</u>	<u>7,525</u>
Income (loss) from discontinued operations	1,083	(1,087)	2,012	(5,130)	754
Cumulative effect of the change in accounting, net of taxes	—	—	(22,756)	—	—
Net income (loss)	<u>\$ 6,625</u>	<u>\$ 9,234</u>	<u>\$ (21,865)</u>	<u>\$ (1,416)</u>	<u>\$ 8,279</u>
Earnings (loss) per share Basic:					
Continuing operations	\$ 0.32	\$ 0.58	\$ (0.06)	\$ 0.21	\$ 0.40
Discontinued operations	0.06	(0.06)	0.11	(0.29)	0.04
Cumulative effect of the change in accounting principle	—	—	(1.24)	—	—
Basic earnings (loss) per share	<u>\$ 0.38</u>	<u>\$ 0.52</u>	<u>\$ (1.19)</u>	<u>\$ (0.08)</u>	<u>\$ 0.44</u>
Diluted:					
Continuing operations	\$ 0.31	\$ 0.57	\$ (0.06)	\$ 0.20	\$ 0.39
Discontinued operations	0.06	(0.06)	0.11	(0.28)	0.04
Cumulative effect of the change in accounting principle	—	—	(1.24)	—	—
Diluted earnings (loss) per share	<u>\$ 0.37</u>	<u>\$ 0.51</u>	<u>\$ (1.19)</u>	<u>\$ (0.08)</u>	<u>\$ 0.43</u>
Weighted average number of common and common equivalent shares outstanding:					
Basic	<u>17,444</u>	<u>17,786</u>	<u>18,334</u>	<u>18,545</u>	<u>19,020</u>
Diluted	<u>17,808</u>	<u>18,260</u>	<u>18,334</u>	<u>18,912</u>	<u>19,507</u>
OPERATING AND FINANCIAL DATA:					
Funeral homes at end of period	139	135	133	131	139
Cemeteries at end of period	30	30	29	28	32
Funeral services performed	23,323	22,673	22,792	22,468	23,545
Preneed funeral contracts sold	5,174	4,936	4,877	4,998	5,075
Backlog of preneed funeral contracts	59,696	60,309	58,531	56,719	68,909
Average per funeral contract	\$ 4,726	\$ 4,890	\$ 4,965	\$ 5,120	\$ 5,207
Cremation rate	29.9%	31.4%	33.1%	34.4%	35.8%
Depreciation and amortization	\$ 9,741	\$ 10,560	\$ 9,053	\$ 8,664	\$ 9,526
BALANCE SHEET DATA:					
Total assets	\$ 538,917	\$ 565,156	\$ 570,640	\$ 564,996	\$ 610,807
Working capital (deficit)	(14,285)	4,933	26,915	35,755	11,647
Long-term debt, net of current maturities	105,355	102,714	134,572	133,841	132,994
Convertible junior subordinated debenture (1)	—	93,750	93,750	93,750	93,750
Redeemable convertible preferred stock (TIDES) (1)	90,327	—	—	—	—
Stockholders' equity	\$ 105,930	\$ 116,438	\$ 96,374	\$ 96,373	\$ 106,900

(1) When the TIDES were issued in 1999, we reported the securities as a component of temporary equity because they have predominantly equity-like characteristics which are not normally found in debt securities (including traditional subordinated debt). In 2004, we changed that classification to report the securities as subordinated debt in order to comply with a new accounting standard.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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 December 31, 2007, we operated 139 funeral homes in 25 states and 32 cemeteries in 11 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; 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 37% 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.

The cemetery operating results are affected by the size and success of our sales organization because more than one half of our cemetery revenues for the year ended December 31, 2007 relate to sales of grave sites and mausoleums and related merchandise and services before the time of need, which we refer to as “preneed”. We believe that changes in the level of consumer confidence (a measure of whether consumers will spend for discretionary items) also affect the amount of cemetery revenues. Approximately 11% of our cemetery revenues for the year ended December 31, 2007 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.

We have implemented several significant long-term initiatives in our operations designed to improve operating and financial results by growing market share and increasing profitability. We introduced a more decentralized, entrepreneurial and local operating model that included operating and financial standards developed from our best operations, along with an incentive compensation plan to reward business managers for successfully meeting or exceeding the standards. The model essentially eliminated the use of financial budgets in favor of the standards. The operating model and standards, which we refer to as “Being the Best,” focus on the key drivers of a successful 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 business. To date, the “Being the Best” operating model and standards have driven significant changes in our organization, leadership and operating practices. In certain businesses we have determined that the business managers do not possess the characteristics to succeed in this type of culture, and we have been actively recruiting new managers who do. Being the best is not something that occurs easily and quickly, but we believe execution of the model produced improved results in 2007 should result in improving sustainable earnings in 2008 and beyond.

Acquisitions

Our growth strategy includes the execution of the Strategic Portfolio Optimization Model. The goal of that model is to build concentrated groups of businesses in ten to fifteen strategic markets. We assess acquisition candidates using six strategic ranking criteria and to differentiate the price we are willing to pay. Those criteria are:

- Size of business
- Size of market
- Competitive standing
- Demographics
- Strength of brand
- Barriers to entry

[Table of Contents](#)

In general terms, our price expectations range from four to five times pre-tax earnings before depreciation for “tuck-ins” to six to seven times pre-tax earnings before depreciation for businesses that rank very high in the ranking criteria. Our expectation at the beginning of the year was to acquire two to three businesses a year. During 2007 we completed seven acquisitions. While the number of completed acquisitions was greater than expected, we continue to plan for two to three each year in the future. Selected information on the acquisitions follows:

Acquisition Date	Type of Business	Market	Estimated Annual Revenue (millions)
January 2007	Combination and Funeral Home	Corpus Christi, TX	\$6.6
April 2007	Combination	Los Angeles, CA	\$3.5
June 2007	Combination and Cemetery	Boise, ID	\$2.8
June 2007	Funeral Home	Santa Fe, NM	\$0.8
August 2007	Five Funeral Homes	Springfield, MA	\$2.2
November 2007	Four Funeral Homes	Los Angeles, CA	\$4.0
November 2007	Funeral Home	Methuen, MA	\$2.1

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, inventories, 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, because there can be no assurance the margins, operating income and net earnings as a percentage of revenues will be consistent 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 accounting principles generally accepted in the United States. Our significant accounting policies are summarized in Note 1 to the Consolidated Financial Statements. 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 and cemetery merchandise and services when the merchandise is delivered or 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 (FAS) No. 66, “Accounting for Sales of Real Estate”. This method generally 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. Revenues to be recognized from the delivery of merchandise and performance of services related to preneed contracts that were acquired in acquisitions are typically lower than those originated by us.

Allowances for bad debts and customer cancellations refunds are provided at the date that sale is recognized as revenue. 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 on 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. Preened selling costs consist of sales commissions and other direct related costs of originating preneed sales contracts. Prior to 2005, these costs were deferred and amortized into funeral and cemetery costs and expenses over the period we expect to perform the services or deliver the merchandise covered by the preneed contracts. The periods over which the costs were recognized were based on actuarial statistics for the actual contracts we hold, provided by a third-party

administrator. Beginning in 2005, we changed our method of accounting for preneed selling costs. Preened selling costs are now expensed as incurred. The cumulative impact of the change was a charge in 2005 in the amount of \$22.8 million, net of tax, equal to \$1.24 per diluted share.

Goodwill

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 reputation 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 FAS 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 our 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 our 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

We and our 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 FAS 109, "Accounting for Income Taxes." We record 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.

In June 2006, FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes how tax benefits for uncertain tax positions are to be recognized, measured, and derecognized in financial statements; requires certain disclosures of uncertain tax matters; specifies how reserves for uncertain tax position should be classified on the balance sheet; and provides transition and interim period guidance, among other provisions. FIN 48 is effective for fiscal years beginning after December 15, 2006 and was adopted by the Company as of January 1, 2007. We have reviewed our income tax positions and identified certain tax deductions, primarily related to business acquisitions that are not certain. The cumulative effect of adopting FIN 48 has been recorded as a reduction to the 2007 opening balance of Retained Earnings and an increase in noncurrent liabilities in the amount of \$0.2 million which includes accrued interest and penalties totaling \$0.1 million. Our policy with respect to potential penalties and interest is to record them as "other" expense and interest expense, respectively.

Stock Compensation Plans

We have stock-based employee compensation plans in the form of restricted stock, stock option and employee stock purchase plans. We account for stock-based compensation under FAS 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 issued to employees over the period of vesting and applies to all transactions involving issuance of equity by a company in exchange for goods and services, including employee services. The fair value of share based payment is determined using the Black-Scholes valuation model. The Company adopted FAS No. 123R as of January 1, 2006, using the modified prospective application method. See Note 1 to the Consolidated Financial Statements.

Prior to 2006, we accounted for stock based compensation under APB No. 25 and provided the disclosures required under FAS No. 123, "Accounting for Stock-Based Compensation", as amended by FAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure." Had we accounted for stock option grants and its employee stock purchase plan under FAS No. 123R for the year ended December 31, 2005, diluted earnings per share for the period would have been lower by approximately \$0.01.

We have granted restricted stock to certain of our officers and key employees, which vest over a period of four years. These shares are valued at the dates granted and the value is charged to operations as the shares vest. No stock options were granted in 2007.

Preneed Funeral and Cemetery Trust Funds

We apply FASB Interpretation No. 46, as revised, (“FIN 46R”), “Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) No. 51” which clarifies the circumstances in which certain entities that do not have equity investors with a controlling financial interest must be consolidated by its sponsor. Our preneed and perpetual care trust funds are consolidated for financial reporting purposes; investments of such trust funds have been reported at market value and our future obligations to deliver merchandise and services have been reported at estimated settlement amounts. We have also recognized the non-controlling financial interests of third parties in the trust funds.

Although FIN 46R requires consolidation of preneed and perpetual care trusts, it did not change the legal relationships among the trusts, the Company and its customers. In the case of preneed trusts, the customers are the principal beneficiaries. In the case of perpetual care trusts, we do not have a right to access the corpus in the perpetual care trusts. For these reasons, we have 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 our 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, in connection with the application of FIN 46R, we recognize the income, gains and losses of the preneed trusts and the unrealized income, gains and losses of the cemetery perpetual care trusts. We recognize 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, we will record such earnings as deferred revenue.

For preneed trusts, we recognize 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, we recognize investment earnings in cemetery revenues when such earnings are realized and distributable. Such earnings are intended to defray cemetery maintenance costs incurred by us.

Business Combinations

We apply the principles provided in FAS No. 141 when we acquire businesses. Tangible and intangible assets acquired and liabilities assumed are recorded at fair value and goodwill is recognized for any difference between the total cost of the acquisition and our fair value determination. We customarily estimate our transaction costs at closing of the acquisition. To the extent that information not available to us at the closing date subsequently becomes available during the allocation period, as defined in FAS No. 141, we may adjust goodwill, assets, or liabilities associated with the acquisition.

Discontinued Operations

In accordance with our Strategic Portfolio Optimization Model, non-strategic businesses are reviewed to determine whether the businesses should be sold and the proceeds redeployed elsewhere. A marketing plan is then developed for those locations which are identified as held for sale. When we receive a letter of intent and financing commitment from the buyer and the sale is expected to occur within one year, the location is no longer reported within our continuing operations. The assets and liabilities associated with the held for sale location are reclassified on the balance sheet and the operating results, as well as impairments, are presented on a comparative basis in the discontinued operations section of the Consolidated Statements of Operations, along with the income tax effect.

RECENT ACCOUNTING PRONOUNCMENTS AND ACCOUNTING CHANGES*Fair Value Measurements*

In September 2006, the FASB issued FAS No. 157, “Fair Value Measurements” (“FAS No. 157”), which establishes a framework for measuring fair value in accordance with Generally Accepted Accounting Principles (“GAAP”) and expands disclosures about fair value measurements. This statement is effective for Carriage beginning January 1, 2008. We do not expect the adoption of FAS No. 157 to have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115” (“FAS No. 159”). This statement permits entities to choose to measure various financial assets and liabilities at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is effective for Carriage beginning January 1, 2008. We do not expect the adoption of FAS No. 159 to have a material impact on our consolidated financial statements.

Business Combinations

In December 2007, the FASB issued FAS No. 141(revised 2007), “Business Combinations” (“FAS No. 141R”). FAS No. 141R requires the acquiring entity to recognize the assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at the acquisition date, measured at the fair values as of that date. Goodwill is measured as a residual of the fair values at acquisition date. Among other charges, acquisition related (transaction) costs are required to be recognized separately from the acquisition and expensed as incurred instead of accounted for as a cost of the acquired business. This statement is effective for us for business combinations for which the acquisition date is on or after January 1, 2009. We are currently evaluating the impact of the adoption of FAS No. 141R on our consolidated financial statements which will be dependent on future business combinations.

Non-controlling Interests

In December 2007, the FASB issued FAS No. 160, “Non-controlling Interests in Consolidated Financial Statements” (“FAS No. 160”). FAS No. 160 requires non-controlling interests in a subsidiary be reported as equity in the consolidated financial statements, the attributable net income be identified and presented on the face of the consolidated statement of income and changes in the ownership be accounted for consistently. The statement also includes requirements when an interest is deconsolidated. Disclosure should be sufficient to clearly identify and distinguish between the interests of the reporting entity and that of the non-controlling interests owners. This statement is effective as of the beginning of our first fiscal year that begins after December 15, 2008. We are currently evaluating the impact, if any, of the adoption of FAS No. 160 on our consolidated financial statements.

SELECTED INCOME AND OPERATIONAL DATA

The following table sets forth certain income statement data for Carriage expressed as a percentage of net revenues for the periods presented:

	Year Ended December 31,		
	2005	2006	2007
Total revenues	100.0%	100.0%	100.0%
Total gross profit	23.9	23.0	27.3
General and administrative expenses	8.3	8.0	9.5
Operating income	16.1	15.0	17.7
Interest expense	12.5	12.3	10.9

[Table of Contents](#)

The following table sets forth the number of funeral homes and cemeteries owned and operated by us for the periods presented:

	Year Ended December 31,		
	2005	2006	2007
Funeral homes at beginning of period	135	133	131
Acquisitions	2	1	14
Divestitures, mergers or closures of existing funeral homes	4	3	6
Funeral homes at end of period	<u>133</u>	<u>131</u>	<u>139</u>
Cemeteries at beginning of period	30	29	28
Acquisitions	—	—	4
Divestitures	1	1	—
Cemeteries at end of period	<u>29</u>	<u>28</u>	<u>32</u>

The following is a discussion of our results of operations for 2005, 2006, and 2007. The term “same-store” or “existing operations” refers to funeral homes and cemeteries owned and operated for the entirety of each period being compared. Funeral homes and cemeteries purchased after January 2005 (date of refinancing our Senior Debt) are referred to as “acquired”.

YEAR ENDED DECEMBER 31, 2007 COMPARED TO YEAR ENDED DECEMBER 31, 2006

The following is a discussion of our results of operations for the years ended December 31, 2006 and 2007.

Net income from continuing operations for the year ended December 31, 2007 totaled \$7.5 million, equal to \$0.39 per diluted share as compared to \$3.7 million for the year ended December 31, 2006, or \$0.20 per diluted share. The variance between the two periods was primarily due to the positive results of acquired businesses, improved results from Rolling Hills Memorial Park and improved results from existing funeral homes in the Central Region. Acquired businesses provided an increase in pre-tax gross profit of \$4.5 million, equal to \$0.14 per diluted share. Improved results at Rolling Hills Memorial Park provided an increase in pre-tax gross profit of \$2.4 million, equal to \$0.07 per diluted share, primarily on the strength of higher preneed revenues and the absence of \$0.7 million in environmental remediation costs incurred in 2006. The existing funeral homes in the Central Region generated \$1.7 million in additional earnings equal to \$0.09 per diluted share. Offsetting a portion of improvement in gross profit from the funeral home and cemetery operations was an increase in corporate costs and expenses of \$4.0 million, equal to \$0.12 per diluted share.

Income from discontinued operations for the year ended December 31, 2007 totaled \$0.8 million, equal to \$0.04 per diluted share. During 2007, we sold four funeral home businesses for approximately \$3.2 million and recognized gains of \$1.2 million. Loss from discontinued operations for the year ended December 31, 2006 totaled \$5.1 million, equal to \$(0.28) per diluted share, and consisted primarily of proceeds of \$6.5 million and impairment charges of \$8.4 million, related to specifically identified goodwill, recorded for four funeral home businesses and a combination funeral home and cemetery business. Two of these businesses were sold in 2007.

[Table of Contents](#)

Funeral Home Segment. The following table sets forth certain information regarding our revenues and gross profit from the funeral home operations for the year ended December 31, 2006 compared to the year ended December 31, 2007.

	Year Ended December 31,		Change	
	2006	2007	Amount	Percent
	(dollars in thousands)			
Total same-store revenue	\$ 110,581	\$ 111,900	\$ 1,319	1.2%
Acquired	1,339	10,710	9,371	*
Preneed insurance commissions revenue	2,267	2,198	(69)	(3.0%)
Revenues from continuing operations	\$ 114,187	\$ 124,808	\$ 10,621	9.3%
Revenues from discontinued operations	\$ 3,669	\$ 628	\$ (3,041)	*
Total same-store gross profit	\$ 39,729	\$ 43,023	\$ 3,294	8.3%
Acquired	313	3,724	3,411	*
Preneed insurance	826	369	(457)	(55.3%)
Gross profit from continuing operations	\$ 40,868	\$ 47,116	\$ 6,248	15.3%
Gross profit from discontinued operations	\$ 736	\$ (8)	\$ (744)	*

* not meaningful

Funeral same-store revenues for the year ended December 31, 2007 increased \$1.3 million, or 1.2%, when compared to the year ended December 31, 2006 as we experienced an increase of 3.9% in the average revenue per service for those existing operations and the number of services declined by 0.5 million, or 2.6%. Performance was strongest in the Central Region, where the number of contracts increased 1.5% and the contract average increased 5.1%. The Western Region experienced a decrease in the number of contracts equal to 5.3% while the contract average increased 2.1%. The number of contracts in the Eastern Region declined 1.6% while the contract average increased 3.1%.

Total same-store gross profit for the year ended December 31, 2007 increase \$3.3 million, or 8.3% from 2006, and as a percentage of funeral same-store revenue, increased from 35.9% to 38.4%. The revenue increases were leveraged into pretax earnings growth across all three regions. Pretax earnings increased significantly in the Central Region at \$4.5 million or 39.7%, equal to \$0.14 per diluted share. Additionally, Western and Eastern regions each increased pretax earnings \$1.1 million, or 9.5% and 6.3%, respectively.

As previously discussed, we completed seven acquisitions in 2007 involving twelve new funeral homes. Because of the timing of the acquisitions, the two funeral homes in Corpus Christi, Texas had the largest impact on acquired revenue and gross profit as they were acquired in January 2007. Of the acquired revenue and gross profit, those two funeral homes provided 2.7% and 1.0%.

Cremation services represented 35.8% of the number of funeral services during 2007, compared to 34.4% for 2006. The average revenue for burial contracts increased 4.6% to \$7,384, and the average revenue for cremation contracts increased 7.4% to \$2,734. We have addressed the growing demand for cremation by training the funeral directors to present multiple merchandise and service options to families, resulting in choices that produce higher revenues. The average revenue for "other" contracts, which make up approximately 9.5% of the number of contracts, declined \$0.3 million to \$1,971. Other contracts consist of charges for merchandise or services for which we do not perform a funeral service for the deceased during the period.

[Table of Contents](#)

Cemetery Segment. The following table sets forth certain information regarding our revenues and gross profit from the cemetery operations for the year ended December 31, 2006 compared to the year ended December 31, 2007:

	Year Ended December 31,		Change	
	2006	2007 (dollars in thousands)	Amount	Percent
Total same-store revenue	\$ 36,159	\$ 38,826	\$ 2,667	7.4%
Acquired	—	4,190	4,190	*
Revenues from continuing operations	\$ 36,159	\$ 43,016	\$ 6,857	19.0%
Revenues from discontinued operations	\$ 778	\$ —	\$ (778)	*
Total same-store gross profit	\$ 9,438	\$ 13,468	\$ 4,030	42.7%
Acquired	—	1,053	1,053	*
Gross profit from continuing operations	\$ 9,438	\$ 14,521	\$ 5,083	53.9%
Gross profit from discontinued operations	\$ 117	\$ —	\$ (117)	*

* not meaningful

Cemetery same-store revenues for the year ended December 31, 2007 increased \$2.7 million, or 7.4% compared to the year ended December 31, 2006, the majority (\$2.4 million) of which was due to higher revenues at our largest business, Rolling Hills Memorial Park, and secondarily to broadly higher performance in our Central Region cemeteries. Same-store atneed revenues increased from \$13.1 million to \$13.7 million. Same-store revenue from preneed property sales increased \$2.0 million while revenues from merchandise and service deliveries declined \$0.5 million.

Cemetery same-store gross profit for the year ended December 31, 2007 increased \$4.0 million, or 42.7%. As a percentage of revenues, cemetery same store gross profit increased from 26.1% to 34.7%, the primary reason was the \$3.4 million improvement at Rolling Hills in part due to the absence of an environmental remediation charge in the amount of \$0.7 million during the 2006 period. Improved collection efforts on preneed receivables resulted in \$0.9 million less bad debt expense in 2007 compared to 2006.

Acquired revenue and gross profit for the year ended December 31, 2007 represents the results of Seaside Memorial Park in Corpus Christi, Texas which was acquired in January 2007, Conejo Mountain Memorial Park in Camarillo, California, which was acquired in April 2007 and Cloverdale Park, Inc. which was acquired in June 2007.

Financial revenues (trust earnings and finance charges on installment contracts) increased \$0.8 million on the strength of higher trust earnings. Earnings from perpetual care trust funds are included in financial revenues and totaled \$2.4 million for the year ended December 31, 2007 compared to \$1.9 million for the year ended December 31, 2006. The year over year improvements were largely due to realized gains in equity investments which have appreciated in line with the markets during the last two to three years.

Other. General and administrative expenses increased \$4.0 million for the year ended December 31, 2007 primarily because we upgraded our consolidation platform systems, infrastructure and people. During 2007, we made significant improvements in numerous home office departments including Strategic Development, Legal, Human Resources and Training, all of which are under new leadership compared to prior years. We view any controllable overhead above our individual businesses as a support cost that needs to be value added to our field operating leadership, our employees and to our client families. Other increases related primarily to four areas: unusually high litigation costs in four cases; higher employee matching contributions under our 401K program; higher recruiting fees related to successful operating leadership searches; and incentive compensation based on performance. We paid out more incentive compensation during 2007 than at any time in our history and have converted 100% of our Managing Partner Incentive Compensation to Standards Achievement.

Interest income and other, net for the year ended December 31, 2007 is primarily interest income on the short-term investments. Interest income declined during the year as a direct result of our investments maturing and cash was used for the acquisitions.

Income taxes. See Note 17 to the Consolidated Financial Statements for a discussion of the income taxes for 2007 and 2006.

YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005

The following is a discussion of our results of operations for the years ended December 31, 2005 and 2006.

Net income from continuing operations for the year ended December 31, 2006 totaled \$3.8 million, equal to \$0.20 per diluted share as compared to a net (loss) from continuing operations of \$(1.0) million for the year ended December 31, 2005, or \$(0.05) per diluted share. The variance between the two periods was primarily due to a \$6.0 million make-whole payment during the first quarter of 2005 to the former debtholders in connection with the repayment of previously outstanding senior debt along with a charge in the amount of \$0.9 million to write off the related unamortized loan costs, in total equal to \$0.24 per diluted share. 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. During 2006, we recorded charges of approximately \$0.8 million for environmental remediation, equal to \$0.03 per diluted share. Excluding the effect of these items, diluted earnings per share from continuing operations for the year ended December 31, 2005 equaled \$0.20 compared to \$0.23 for the year ended December 31, 2006.

There are two major operational areas that management is focused on to improve results: (1) The Central Region funeral operations, which suffered a year over year decline in pretax profitability of \$0.7 million, and (2) a cemetery in California, whose pretax profits declined by \$2.6 million compared to 2005. The decline in profitability in these two areas is equivalent to \$(0.12) per diluted share for the year. We recently made changes in leadership over each of these areas to focus on the issues affecting profits, such as local sales management, receivable collections, expense management, pricing and marketshare losses.

(Loss) from discontinued operations for the year ended December 31, 2006 totaled \$(5.2) million, equal to \$(0.28) per diluted share. During 2006, we sold a funeral home business and a combination funeral home and cemetery business for approximately \$6.5 million and ceased operations at a funeral home business. We recorded impairment charges of \$6.3 million, a substantial portion of which related to specifically identified goodwill, and recognized \$0.2 million of net losses. We recorded additional impairment charges totaling \$2.1 million, which is related to specifically identified goodwill, for three funeral home businesses to be sold in 2007. The sales of two of these businesses were completed in January and February of 2007. Income from discontinued operations for the year ended December 31, 2005 totaled \$1.9 million, equal to \$0.10 per diluted share, and consisted primarily of a gain on the sale of a funeral home business during the first quarter of 2005.

Funeral Home Segment. The following table sets forth certain information regarding our revenues and gross profit from the funeral home operations for the year ended December 31, 2005 compared to the year ended December 31, 2006.

	Year Ended December 31,		Change	
	2005	2006	Amount	Percent
	(dollars in thousands)			
Total same-store revenue	\$ 111,606	\$ 114,497	\$ 2,891	2.6%
Less: businesses held for sale	(2,258)	(1,837)	421	*
Preneed insurance commissions revenue	2,295	2,267	(28)	(1.2)%
Revenues from continuing operations	<u>\$ 111,643</u>	<u>\$ 114,927</u>	<u>\$ 3,284</u>	2.9%
Revenues from discontinued operations	<u>\$ 4,707</u>	<u>\$ 3,007</u>	<u>\$ (1,700)</u>	*
Total same-store gross profit	\$ 29,830	\$ 29,600	\$ (230)	(0.8)%
Less: businesses held for sale	(651)	(317)	334	*
Preneed insurance	13	826	813	*
Gross profit from continuing operations	<u>\$ 29,192</u>	<u>\$ 30,109</u>	<u>\$ 917</u>	3.1%
Gross profit from discontinued operations	<u>\$ 1,167</u>	<u>\$ 551</u>	<u>\$ (616)</u>	*

* not meaningful

Funeral same-store revenues for the year ended December 31, 2006 increased \$2.9 million, or 2.6%, when compared to the year ended December 31, 2005, as we experienced an increase of 3.1% to \$5,149 in the average revenue per service for those existing operations and the number of services declined by 107, or 0.5%. Performance was strong in the Eastern Region, where the number of contracts increased 2.9% and the contract average increased 3.7%. The Western Region number of contracts remained constant, while the contract average increased 5.2%. The Central Region suffered a decline of 5.5% in the number of contracts and an increase of 1.1% in the contract average. Cremation services represented 34.3% of the number of funeral services during 2006, compared to

[Table of Contents](#)

32.8% for 2005. The average revenue for burial contracts increased 4.6% to \$7,076, and the average revenue for cremation contracts increased 8.4% to \$2,636. We have addressed the growing demand for cremation by training the funeral directors to present multiple merchandise and service options to families, resulting in choices that produce higher revenues.

Total funeral same-store gross profit for the year ended December 31, 2006 decreased \$0.2 million, or 0.8% from 2005, yet as a percentage of revenue, remained constant year over year. We experienced a 2.4% increase in funeral operating expenses yet lower pretax earnings in our Central Region of \$0.7 million, equal to \$0.02 per diluted share.

Cemetery Segment. The following table sets forth certain information regarding our revenues and gross profit from the cemetery operations for the year ended December 31, 2006 compared to the year ended December 31, 2005:

	Year Ended December 31,		Change	
	2005	2006	Amount	Percent
	(dollars in thousands)			
Revenues from continuing operations	\$ 37,555	\$ 36,159	\$ (1,396)	(3.7)%
Revenues from discontinued operations	\$ 1,851	\$ 778	\$ (1,073)	*
Gross profit from continuing operations	\$ 6,525	\$ 3,943	\$ (2,582)	(39.6)%
Gross profit from discontinued operations	\$ 371	\$ 121	\$ (250)	*

* not meaningful

Cemetery same-store revenues for the year ended December 31, 2006 decreased \$1.4 million, or (3.7)%, over the year ended December 31, 2005, and cemetery same store gross profit decreased \$2.6 million, or (39.6)%, over 2005. Revenues from preneed interment sales decreased \$1.7 million. Though the number of interments sold on a preneed basis declined 0.6 million, or 8.5%, over 2005, the average price per space increased 8.6%. Continuing gross margin decreased from 17.4% for the year ended December 31, 2005 to 10.9% for the year ended December 31, 2006. The decline in revenues and gross profits from continuing operations relates to a particular California cemetery that experienced a decline of \$2.1 million in preneed property sales, an increase in bad debts of \$0.2 million and a decline of \$0.2 million in atneed revenues. Financial revenues (trust earnings and finance charges on installment contracts) increased \$0.2 million on the strength of higher trust earnings.

Other. General and administrative expenses decreased \$1.1 million for the year ended December 31, 2006 primarily because 2005 included higher professional fees related to our compliance with the internal control requirements of Sarbanes-Oxley and the development of a new cemetery system. We first recognized compensation expense related to its stock options and employee stock purchase plan under a new accounting standard in 2006. See Note 1 to the Consolidated Financial Statement. Stock-based compensation totaling \$236,000 is included in general and administrative expenses for the year ended December 31, 2006.

Other income for the year ended December 31, 2006 includes a gain on the sale of excess real estate and interest income on the short-term investments.

Income taxes. See Note 17 to the Consolidated Financial Statements for a discussion of the income taxes for 2005 and 2006.

LIQUIDITY AND CAPITAL RESOURCES

Carriage began 2007 with \$41.0 million in cash and other liquid investments and ended the year with \$3.4 million in cash and an undrawn \$35 million line of credit. The elements of cash flow for 2007 consisted of the following (in millions):

Cash and liquid investments at beginning of year	\$ 41.0
Cash flow from operations	19.6
Proceeds from sales of businesses	3.2
Cash used for business acquisitions	(48.6)
Cash used for maintenance capital expenditures	(7.9)
Cash used for growth capital expenditures	(3.8)
Other investing and financing activities	(0.1)
Cash at end of year	<u>\$ 3.4</u>

The outstanding principal of senior debt at December 31, 2007 totaled \$138.9 million and consisted of \$130.0 million in Senior Notes, described below, and \$8.9 million in acquisition indebtedness and capital lease obligations. Additionally, \$0.4 million in letters of credit were issued under the credit facility and were outstanding at December 31, 2007.

In January 2005, we issued \$130 million of 7.875% Senior Notes due in 2015. The proceeds from these notes were used to refinance the Series 1999 Senior Notes (including payments for accrued interest and make-whole payments), to bring current the deferred distributions on the convertible junior subordinated debentures and the TIDES, and for general corporate purposes. In connection with the early retirement of the senior debt, we made a required “make whole” payment of \$6.0 million (recorded as additional interest) and recorded a charge to write off \$0.7 million of unamortized loan costs. These charges equal \$4.2 million after tax, or \$0.23 per diluted share, and were reported in the first quarter of 2005. The refinancing improved our liquidity by replacing debt totaling approximately \$96 million due in 2006 and 2008 with debt maturing in 2015.

In April 2005, we entered into a \$35 million senior secured revolving credit facility that matures in 2010 and is collateralized by all personal property and funeral home real property in certain states. Borrowings under the credit facility bear interest at either prime or LIBOR options. At December 31, 2007, the LIBOR option was set at LIBOR plus 275 basis points. The facility is undrawn, except for the letters of credit referred to above, at December 31, 2007.

A total of \$93.8 million was outstanding on December 31, 2007 on the convertible junior subordinated debenture. Amounts outstanding under the debenture are payable to our affiliate trust, Carriage Services Capital Trust, bear interest at 7.0% and mature in 2029. Substantially all the assets of the Trust consist of the convertible junior subordinated debentures. In 1999, the Trust issued 1.875 million shares of term income deferrable equity securities (“TIDES”). The rights of the debentures 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 at our discretion. During the period in which distribution payments are deferred, distributions will continue to accumulate at the 7% annual rate. Also, the deferred distributions themselves accumulate distributions at the annual rate of 7% and are recorded as a liability. During the deferral period, we are prohibited from paying dividends on common stock or repurchasing common stock, subject to limited exceptions. We deferred distributions on the TIDES from September 2003 through December 2004. In March 2005, we paid the \$10.3 million for the cumulative deferred distributions on the TIDES and are currently paying the quarterly interest and distributions.

We intend to use our cash, cash flow provided by operations and proceeds from the sale of businesses, to acquire funeral home and cemetery businesses and to invest in internal projects that will result in revenue and earnings growth. We also have the ability to draw on our revolving credit facility, subject to customary terms and conditions of the credit agreement, to finance acquisitions.

[Table of Contents](#)

Balance Sheet Obligations

The following table summarizes the future payments required for the debt on our balance sheet as of December 31, 2007. Where appropriate we have indicated the footnote to our annual Consolidated Financial Statements where additional information is available.

	Note Reference	Total	Payments By Period (in millions)					After 5 Years
			2008	2009	2010	2011	2012	
Long-term debt	14	\$134.2	1.2	0.7	0.4	0.4	0.4	131.1
Capital lease obligations	16	10.2	0.6	0.6	0.7	0.6	0.7	7.0
Convertible junior subordinated debenture (a)	15	93.8	—	—	—	—	—	93.8
Total contractual obligations		\$238.2	1.8	1.3	1.1	1.0	1.1	231.9

(a) Matures in 2029

Off-Balance Sheet Arrangements

The following table summarizes our off-balance sheet arrangements as of December 31, 2007. Where appropriate we have indicated the footnote to our annual Consolidated Financial Statements where additional information is available.

	Note Reference	Total	Payments By Period (in millions)					After 5 Years
			2008	2009	2010	2011	2012	
Operating leases	16	\$ 10.3	\$ 2.2	\$ 1.6	\$ 1.2	\$ 0.9	\$ 0.9	\$ 3.5
Interest payments on long-term debt	14	114.2	17.5	17.4	17.3	17.1	17.1	27.8
Noncompete agreements	16	3.2	1.0	0.7	0.5	0.3	0.3	0.4
Consulting agreements	16	0.9	0.4	0.2	0.1	0.1	—	0.1
Executive Management agreements	16	5.9	2.3	2.2	1.4	—	—	—
Total contractual cash obligations		\$134.5	\$23.4	\$22.1	\$20.5	\$18.4	\$18.3	\$31.8

The obligations related to our off-balance sheet arrangements are significant to our future liquidity; however, although we can provide no assurances, we anticipate that these obligations will be funded from cash provided from our operating activities. If we are not able to meet these obligations with cash provided for by our operating activities, we may be required to access the capital markets or draw down on our credit facilities.

SEASONALITY

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

INFLATION

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

FORWARD-LOOKING STATEMENTS

In addition to historical information, this Annual Report on Form 10-K 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, cash flow, debt levels or other financial items; any statements of the plans, strategies and objectives of management for future operation; 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. Forward-looking statements are not guarantees of performance. Important factors that could cause actual results to differ materially from our expectations reflected in our forward-looking statements include those risks related to our business and our industry set forth in Item 1A. Risk Factors.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to changes in market values related to outstanding debts and changes in the values of securities associated with the preneed and perpetual care trusts. Management is actively involved in monitoring exposure to market risk and developing and utilizing appropriate risk management techniques when appropriate and when available for a reasonable price. We are not exposed to any other significant market risks including commodity price risk, nor foreign currency exchange risk.

We monitor current and forecasted interest rate risk in the ordinary course of business and seek to maintain optimal financial flexibility, quality and solvency. As of December 31, 2007, our outstanding debt is comprised of entirely fixed rate obligations.

We do not currently have any floating rate long-term borrowings outstanding under its \$35 million floating rate line of credit. If we borrow against the line of credit, any change in the floating rate would cause a change in interest expense.

The 7.875% Senior Notes were issued to the public at par and are carried at a cost of \$130 million. At December 31, 2007, these securities were typically trading at prices ranging from 98.0 to 99.0.

The convertible junior subordinated debenture payable to Carriage Services Capital Trust pays interest at the fixed rate of 7% and are carried on the Company's balance sheet at a cost of approximately \$93.8 million. The estimated fair value of these securities is estimated to be \$82.5 million at December 31, 2007 based on available broker quotes of the corresponding preferred securities issued by the Trust.

Increases in market interest rates may cause the value of these debt instruments to decrease but such changes will not affect our interest costs. The remainder of the our long-term debt and leases consist of non-interest bearing notes and fixed rate instruments that do not trade in a market, nor otherwise have a quoted market value. Any increase in market interest rates causes the fair value of those liabilities to decrease.

Securities subject to market risk consist of investments held by our preneed funeral, cemetery merchandise and services and perpetual care trust funds. See Notes 9, 10 and 12 to our Consolidated Financial Statements for the estimated fair values of those securities.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

**CARRIAGE SERVICES, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	<u>Page</u>
CONSOLIDATED FINANCIAL STATEMENTS:	
Management's Report on Internal Control over Financial Reporting	33
Attestation of Independent Registered Public Accounting Firm	34
Report of Independent Registered Public Accounting Firm	35
Consolidated Balance Sheets as of December 31, 2006 and 2007	36
Consolidated Statements of Operations for the Years Ended December 31, 2005, 2006 and 2007	37
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2005, 2006 and 2007	38
Consolidated Statements of Cash Flows for the Years Ended December 31, 2005, 2006 and 2007	39
Notes to Consolidated Financial Statements	40

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined under Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934, as amended.

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's Consolidated Financial Statements for external purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of the Consolidated Financial Statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with appropriate authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the Consolidated Financial Statements.

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

Management conducted an assessment of the Company's internal control over financial reporting as of December 31, 2007 using the framework specified in *Internal Control — Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission. Based on such assessment, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2007.

The Company's internal control over financial reporting as of December 31, 2007 has been audited by KPMG LLP, an independent registered public accounting firm, which also audited the financial statements of the Company for the year ended December 31, 2007, as stated in their report which is presented in this Annual Report.

/s/ Melvin C. Payne

Melvin C. Payne

Chairman of the Board, President and Chief Executive Officer

/s/ Joseph Saporito

Joseph Saporito

Executive Vice President and Chief Financial Officer

March 14, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Carriage Services, Inc.:

We have audited Carriage Services, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Carriage Services, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Carriage Services, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Carriage Services, Inc. as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007, and our report dated March 14, 2008, expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Houston, Texas
March 14, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Carriage Services, Inc.:

We have audited the accompanying consolidated balance sheets of Carriage Services, Inc. and subsidiaries as of December 31, 2007 and 2006 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Carriage Services, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007 in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. Also as discussed in Note 1 to the consolidated financial statements, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Carriage Services, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 14, 2008 expressed an unqualified opinion on the effectiveness of internal control over financial reporting.

/s/ KPMG LLP

Houston, Texas
March 14, 2008

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

	December 31,	
	2006	2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 22,820	\$ 3,446
Short term investments	10,303	—
Accounts receivable, net of allowance for bad debts of \$925 in 2006 and \$1,142 in 2007	13,822	16,421
Assets held for sale	2,634	—
Inventories and other current assets	11,883	13,686
Total current assets	<u>61,462</u>	<u>33,553</u>
Restricted cash	2,888	—
Preneed cemetery trust investments	55,483	61,114
Preneed funeral trust investments	44,851	68,292
Preneed receivables, net of allowance for bad debts of \$1,203 in 2006 and \$1,159 in 2007	15,127	18,333
Receivables from preneed funeral trusts	15,649	15,012
Property, plant and equipment, net of accumulated depreciation of \$47,250 in 2006 and \$53,304 in 2007	99,894	125,608
Cemetery property	57,798	68,028
Goodwill	148,845	167,263
Deferred charges and other non-current assets	30,459	16,402
Cemetery perpetual care trust investments	32,540	37,202
Total assets	<u>\$ 564,996</u>	<u>\$ 610,807</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and obligations under capital leases	\$ 1,610	\$ 1,256
Accounts payable	7,148	6,091
Accrued liabilities	15,888	14,559
Liabilities associated with assets held for sale	1,061	—
Total current liabilities	<u>25,707</u>	<u>21,906</u>
Senior long-term debt, net of current portion	133,841	132,994
Convertible junior subordinated debenture due in 2029 to an affiliated trust	93,750	93,750
Obligations under capital leases, net of current portion	4,728	4,663
Deferred preneed cemetery revenue	50,785	50,610
Deferred preneed funeral revenue	28,289	34,277
Non-controlling interests in cemetery trust investments	55,483	61,114
Non-controlling interests in funeral trust investments	44,851	68,292
Total liabilities	<u>437,434</u>	<u>467,606</u>
Commitments and contingencies		
Non-controlling interests in perpetual care trust investments	31,189	36,301
Stockholders' equity:		
Common Stock, \$.01 par value; 80,000,000 shares authorized; 18,608,000 and 19,216,000 issued and outstanding in 2006 and 2007, respectively	186	192
Additional paid-in capital	190,524	193,006
Accumulated deficit	(94,337)	(86,298)
Total stockholders' equity	<u>96,373</u>	<u>106,900</u>
Total liabilities and stockholders' equity	<u>\$ 564,996</u>	<u>\$ 610,807</u>

The accompanying notes are an integral part of these Consolidated Financial Statements.

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

	For the years ended December 31,		
	2005	2006	2007
Revenues:			
Funeral	\$ 110,882	\$ 114,187	\$ 124,808
Cemetery	37,555	36,159	43,016
	148,437	150,346	167,824
Field costs and expenses:			
Funeral	72,429	73,319	77,692
Cemetery	26,076	26,721	28,495
Depreciation and amortization	8,577	8,375	8,139
Regional and unallocated funeral and cemetery costs	5,854	7,303	7,698
	112,936	115,718	122,024
Gross profit	35,501	34,628	45,800
Corporate costs and expenses:			
General, administrative and other	11,110	10,590	14,628
Home office depreciation and amortization	1,273	1,432	1,387
	12,383	12,022	16,015
Other income	(822)	—	—
Operating income	23,940	22,606	29,785
Interest expense	(18,587)	(18,508)	(18,344)
Additional interest and other costs of senior debt refinancing	(6,933)	—	—
Interest income and other, net	(73)	1,921	1,152
Total interest and other	(25,593)	(16,587)	(17,192)
Income (loss) from continuing operations before income taxes	(1,653)	6,019	12,593
(Provision) benefit for income taxes	532	(2,305)	(5,068)
Net income (loss) from continuing operations	(1,121)	3,714	7,525
Income (loss) from discontinued operations, net of tax	2,012	(5,130)	754
Cumulative effect of change in accounting method, net of tax	(22,756)	—	—
Net income (loss)	<u>\$ (21,865)</u>	<u>\$ (1,416)</u>	<u>\$ 8,279</u>
Basic earnings (loss) per common share:			
Continuing operations	\$ (0.06)	\$ 0.21	\$ 0.40
Discontinued operations	0.11	(0.29)	0.04
Cumulative effect of change in accounting method	(1.24)	—	—
Net income (loss)	<u>\$ (1.19)</u>	<u>\$ (0.08)</u>	<u>\$ 0.44</u>
Diluted earnings (loss) per common share:			
Continuing operations	\$ (0.06)	\$ 0.20	\$ 0.39
Discontinued operations	0.11	(0.28)	0.04
Cumulative effect of change in accounting method	(1.24)	—	—
Net income (loss)	<u>\$ (1.19)</u>	<u>\$ (0.08)</u>	<u>\$ 0.43</u>
Weighted average number of common and common equivalent shares outstanding:			
Basic	18,334	18,545	19,020
Diluted	18,334	18,912	19,507

The accompanying notes are an integral part of these Consolidated Financial Statements.

CARRIAGE SERVICES, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands)

	Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total
Balance – December 31, 2004	17,910	\$ 179	\$ 187,315	\$ (71,056)	\$ 116,438
Net loss – 2005	—	—	—	(21,865)	(21,865)
Issuance of common stock	118	1	685	—	686
Exercise of stock options	177	2	528	—	530
Issuance of restricted common stock	268	3	(3)	—	—
Cancellation and retirement of restricted common stock	(15)	—	—	—	—
Amortization of restricted common stock	—	—	585	—	585
Balance – December 31, 2005	18,458	185	189,110	(92,921)	96,374
Net loss – 2006	—	—	—	(1,416)	(1,416)
Issuance of common stock	93	1	386	—	387
Exercise of stock options	87	1	319	—	320
Issuance of restricted common stock	35	—	—	—	—
Cancellation and retirement of restricted common stock	(65)	(1)	1	—	—
Amortization of restricted common stock	—	—	472	—	472
Stock-based compensation expense	—	—	236	—	236
Balance – December 31, 2006	18,608	186	190,524	(94,337)	96,373
Net Income – 2007	—	—	—	8,279	8,279
Adoption of FIN 48	—	—	—	(240)	(240)
Issuance of common stock	119	1	601	—	602
Exercise of stock options	219	2	996	—	998
Issuance of restricted common stock	309	3	(3)	—	—
Cancellation and retirement of restricted common stock	(40)	—	34	—	34
Amortization of restricted common stock	—	—	723	—	723
Stock-based compensation expense	—	—	131	—	131
Balance – December 31, 2007	<u>19,215</u>	<u>\$ 192</u>	<u>\$ 193,006</u>	<u>\$ (86,298)</u>	<u>\$ 106,900</u>

The accompanying notes are an integral part of these Consolidated Financial Statements.

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

	For the years ended December 31,		
	2005	2006	2007
Cash flows from operating activities:			
Net income (loss)	\$ (21,865)	\$ (1,416)	\$ 8,279
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
(Income) loss from discontinued operations, net of tax	(2,012)	5,130	(754)
Cumulative effect of change in accounting method, net of tax	22,756	—	—
Depreciation and amortization	9,053	8,664	9,526
Amortization of deferred financing costs	754	714	714
Provision for losses on accounts receivable	2,648	3,880	3,398
(Gain) loss on sale or disposition of assets	738	(513)	—
Stock-based compensation expense	675	784	1,141
Deferred income taxes (benefit)	(532)	2,305	5,068
Other	(133)	122	(233)
Changes in operating assets and liabilities that provided (required) cash, net of effects from acquisitions			
Accounts receivable	(3,623)	(2,109)	(4,498)
Inventories and other current assets	(1,039)	336	17
Deferred charges and other	(818)	12	(15)
Preneed funeral and cemetery trust investments	(7,477)	(13,888)	757
Accounts payable and accrued liabilities	(1,408)	613	(3,524)
Deferred preneed funeral and cemetery revenue	10,893	10,095	(5,634)
Non-controlling interests in preneed funeral and cemetery trusts investments	1,825	2,526	5,319
Deferred interest on convertible junior subordinated debenture	(10,345)	—	—
Net cash provided by operating activities of discontinued operations	1,649	928	10
Net cash provided by operating activities	1,739	18,183	19,571
Cash flows of investing activities:			
Acquisitions	(1,285)	(1,072)	(48,604)
Net proceeds from sales of assets	586	670	—
Purchase of corporate investments	(32,724)	(50,927)	—
Maturities of corporate investments	15,816	52,533	15,303
Sales proceeds (deposited into) withdrawn from restricted accounts	—	(2,888)	2,888
Capital expenditures	(8,104)	(6,365)	(11,650)
Net cash provided by investing activities of discontinued operations	1,509	6,312	3,241
Net cash used in investing activities	(24,202)	(1,737)	(38,822)
Cash flows of financing activities:			
Payments under bank line of credit	(25,600)	—	—
Payments on senior long-term debt and obligations under capital leases	(72,533)	(2,111)	(1,396)
Proceeds from the issuance of senior notes	130,000	—	—
Payment of financing costs	(4,175)	—	—
Proceeds from the exercise of stock options and employee stock purchase plan	936	567	970
Tax benefit from stock-based compensation	—	63	377
Net cash used in financing activities of discontinued operations	(164)	(94)	(74)
Net cash provided by (used in) financing activities	28,464	(1,575)	(123)
Net increase (decrease) in cash and cash equivalents	6,001	14,871	(19,374)
Cash and cash equivalents at beginning of year	1,948	7,949	22,820
Cash and cash equivalents at end of year	<u>\$ 7,949</u>	<u>\$ 22,820</u>	<u>\$ 3,446</u>

The accompanying notes are an integral part of these Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

Carriage Services, Inc. (“Carriage” or the “Company”) was founded in 1991 and incorporated under the laws of the State of Delaware in 1993. The Company owns and operates 139 funeral homes in 25 states and 32 cemeteries in 11 states at December 31, 2007. Carriage provides a complete range of preneed and atneed services and products related to funerals, burials and cremations.

Principles of Consolidation and Basis of Presentation

The financial statements include the Consolidated Financial Statements of Carriage Services, Inc. and its subsidiaries, after eliminating all significant intercompany balances and transactions. Certain prior year amounts in the Consolidated Financial Statements have been reclassified to conform to current year presentation.

The accounting policies and procedures reflected herein have been consistently followed during the periods presented, except for the changes in accounting methods discussed in Note 1 related to stock-based employee compensation.

Funeral and Cemetery Operations

We record the revenue from sales of funeral and cemetery merchandise and services when the merchandise is delivered or the service is performed. Sales of cemetery interment rights are recorded as revenue in accordance with the retail land sales provisions of Financial Accounting Standards (FAS) 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. 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.

Allowances for bad debts and customer cancellations 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 on the sale of the policies. Insurance commissions are recognized as revenues at the point at which the commission is no longer subject to refund, which is typically one year after the policy is issued.

Trade accounts receivable consists of approximately \$8.3 million and \$10.7 million of funeral receivables and approximately \$6.6 million and \$6.1 million of current preneed cemetery receivables at December 31, 2006 and 2007, respectively. Non-current preneed receivables at December 31, 2006 and 2007, represent the payments expected to be received beyond one year from the balance sheet date. Non-current preneed receivables consist of approximately \$2.2 million and \$5.0 million of funeral receivables and \$12.9 million and \$13.3 million of cemetery receivables at December 31, 2006 and 2007, respectively.

Preneed Contracts

Interment rights, merchandise and services are also sold on a preneed basis and in many instances the customer pays the contract over a period of time. Cash proceeds from preneed sales less amounts that the Company may retain under state regulations are deposited to a trust or used to purchase a third-party insurance policy. The principal and accumulated earnings of the trusts may generally be withdrawn at maturity (death) or cancellation. The trust income earned and the increases in insurance benefits on the insurance products are deferred until the service is performed. The customer receivables and amounts deposited in trusts that Carriage controls are included in the non-current asset section of the balance sheet. The preneed funeral contracts secured by third party insurance policies are not recorded as assets or liabilities of the Company (Note 11).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

In the opinion of management, the proceeds from the trust funds and the insurance policies at the times the preneed contracts mature will exceed the estimated future costs to perform services and provide products under such arrangements. The types of instruments in which the trusts may invest are regulated by state agencies.

Cemetery Perpetual Care Trust Funds

In accordance with respective state laws, the Company is required to deposit a specified amount into perpetual and memorial care trust funds for each interment/entombment right and memorial sold. Income from the trust funds is distributed to Carriage and used to provide care and maintenance for the cemeteries and mausoleums. Such trust fund income is recognized as revenue when realized by the trust and distributable to the Company. The Company is restricted from withdrawing any of the principal balances of these funds.

Cash and Cash Equivalents

Carriage considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Goodwill

The excess of the purchase price over the fair value of net identifiable assets of funeral homes 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 in connection with the acquisitions of cemetery businesses. In accordance with FAS 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.

Inventory

Inventory consists primarily of caskets, outer burial containers and cemetery monuments and markers, and is recorded at the lower of its cost basis (determined by the specific identification method) or net realizable value.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. The costs of ordinary maintenance and repairs are charged to operations as incurred, while renewals and betterments are capitalized. Capitalized interest totaled approximately \$50,000 and \$59,000 in 2006 and 2007, respectively. Depreciation of property, plant and equipment is computed based on the straight-line method over the following estimated useful lives of the assets:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

	Years
Buildings and improvements	15 to 40
Furniture and fixtures	7 to 10
Machinery and equipment	5 to 10
Automobiles	5 to 7

Property, plant and equipment was comprised of the following at December 31, 2006 and 2007:

	December 31, 2006	December 31, 2007
	(in thousands)	
Land	\$ 26,589	\$ 32,476
Buildings and improvements	81,567	100,980
Furniture, equipment and automobiles	41,076	45,456
	149,232	178,912
Less: accumulated depreciation	(47,932)	(53,304)
	\$ 101,300	\$ 125,608
Less: Property, plant and equipment included in assets held for sale	(1,406)	—
	<u>\$ 99,894</u>	<u>\$ 125,608</u>

During 2005, 2006 and 2007, the Company recorded \$6,922,000, \$6,897,000 and \$6,982,000 respectively, for depreciation expense against income from continuing operations.

Long-lived assets, such as property, plant and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. The long-lived assets to be held and used are reported at the lower of carrying amount or fair value. 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.

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 FAS No. 109, "Accounting for Income Taxes", (Note 17). 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. The Company adopted FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" ("FIN 48") at January 1, 2007 as further discussed in Note 4 to the consolidated financial statements.

Stock Compensation Plans

The Company has stock-based employee compensation plans in the form of restricted stock, stock option and employee stock purchase plans. The Company accounts for stock-based compensation under FAS 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 awards issued to employees over the period of vesting and applies to all transactions involving issuance of equity by a company in exchange for goods and services, including employee services. The fair value of awards for options or awards containing options is determined using the Black-Scholes valuation model. The Company adopted FAS No. 123R in the first quarter of 2006, using the modified prospective application method, which results in no restatement of the Company's previously issued annual consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Prior to 2006, the Company accounted for stock based compensation under APB No. 25 and provided the disclosures required under FAS No. 123, "Accounting for Stock-Based Compensation", as amended by FAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure."

Pursuant to the provisions of FAS 123R, the Company applied the modified-prospective transition method. Under this method, the fair value provision of FAS 123R is applied to new employee stock-based awards granted after December 31, 2005. Measurement and recognition of compensation cost for unvested awards at December 31, 2005, granted prior to the adoption of FAS 123R, are recognized under the provisions of FAS No 123, Accounting for Stock-Based Compensation ("FAS 123"), after adjustments for estimated forfeitures. FAS 123R no longer permits pro-forma disclosure for income statement periods after December 31, 2005 and compensation expense will be recognized for all stock-based awards based on grant-date fair value.

Carriage has three types of stock-based compensation plans for which the accounting is changed: stock options, restricted stock and an employee stock purchase plan ("ESPP"). Options to purchase Carriage common stock have been granted with an exercise price equal to the fair market value at the date of grant with vesting generally occurring annually over four years. The value of the options at the date of grant is amortized to compensation expense over the vesting period on a straight line basis. Twenty-five percent of the restricted shares vest annually on each of the next four anniversary dates of the grants. The value of the restricted stock at the date of grant is amortized to compensation expense over the vesting period, generally four years, on a straight line basis. The ESPP allows employees, through payroll deductions, to purchase Carriage common stock at 85% of the value of the common stock on the quarterly purchase dates or the annual grant date, whichever is lower.

The fair value of the stock option awards and the ESPP awards are determined using the Black-Scholes valuation model, which is consistent with the valuation methods previously utilized for the awards in the proforma footnote disclosures required under FAS 123, as amended by FAS No. 148, Accounting for Stock-Based Compensation – Transition and Disclosure. The Company recorded pretax stock-based compensation expense for the stock options and the ESPP totaling \$236,000 and \$131,000 for the year ended December 31, 2006 and 2007, respectively. Had FAS 123R been effective for 2005, the Company would have recorded additional pretax stock-based compensation totaling \$312,000 as disclosed in the following table (in thousands). "As reported" is as of the year FAS No. 123 was adopted thus it has not been affected for discontinued operations since 2005.

		Year ended December 31, 2005	
	As Reported	Effect of Change	Proforma
Loss from continuing operations before income taxes	\$ (1,449)	\$ (312)	\$ (1,761)
Net loss available to common stockholders	(21,865)	(195)	(22,060)
Net loss per share available to common stockholders:			
Basic	\$ (1.19)	\$(0.01)	\$ (1.20)
Diluted	(1.19)	(0.01)	(1.20)

See Note 18 to the consolidated financial statements for additional information on the Company's stock-based compensation plans.

Computation of Earnings Per Common Share

Basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period. Dilutive common equivalent shares consist of stock options.

Fair Value of Financial Instruments

Carriage believes that the carrying value approximates fair value for cash and cash equivalents and trade receivables and payables. Additionally, our floating rate credit facility, when drawn, approximates its fair value. Management estimates that the fair value of senior long-term debt at December 31, 2007 was approximately \$128.1 million, based on available market quotes. Management estimates that the fair value of the Convertible junior subordinated debenture at December 31, 2007 was approximately \$82.5 million, based on available broker quotes of the corresponding convertible preferred securities at Carriage Services Capital Trust.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)***Discontinued Operations*

In accordance with the Company's strategic portfolio optimization model, non-strategic businesses are reviewed to determine whether the business should be sold and proceeds redeployed elsewhere. A marketing plan is then developed for those locations which are identified as held for sale. When the Company receives a letter of intent and financing commitment from the buyer and the sale is expected to occur within one year, the location is no longer reported within the Company's continuing operations. The assets and liabilities associated with the held for sale location are reclassified on the balance sheet and the operating results, as well as impairments, are presented on a comparative basis in the discontinued operations section of the Consolidated Statements of Operations, along with the income tax effect.

Business Combinations

We apply the principles provided in FAS No. 141 when we acquire businesses. Tangible and intangible assets acquired and liabilities assumed are recorded at fair value and goodwill is recognized for any difference between the price of the acquisition and our fair value determination. We customarily estimate our purchase and other related transaction costs known at closing of the acquisition. To the extent that information not available to us at the closing date subsequently becomes available during the allocation period, as defined in FAS No. 141, we may adjust goodwill, assets, or liabilities associated with the acquisition.

Consolidation of Variable Interest Entities

FASB Interpretation No. 46, as revised, ("FIN 46R"), "*Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) No. 51*" 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 implementation of FIN 46R resulted, for financial reporting purposes, in the consolidation of the Company's preneed and perpetual care trust funds. The investments of such trust funds are reported at market value and the Company's future obligations to deliver merchandise and services are reported at estimated settlement amounts. The Company has also recognized the non-controlling financial interests of third parties in the trust funds.

Although FIN 46R requires consolidation of preneed and perpetual care trusts, it did 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 investments* 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*.

The Company recognizes the income, gains and losses of the preneed trusts and the unrealized income, gains and losses of the 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 realized 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.

Also, the Company was required to deconsolidate Carriage Services Capital Trust (the "Trust"), a trust established in 1999 to issue redeemable convertible preferred securities. The Company's obligation to the Trust consists of convertible junior subordinated debentures. The preferred securities of the Trust were previously classified as temporary equity in the consolidated balance sheet. As a result of deconsolidating the Trust, the Company now reports its obligation to the Trust, the convertible junior subordinated debentures, as a long-term liability.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of 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 consistent from year to year.

Impairment of Investments

In March 2004, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 03-1 (EITF 03-1), “*The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*.” The guidance is applicable to debt and equity securities that are within the scope of FASB Statement of Financial Accounting Standard (SFAS) No. 115, “*Accounting for Certain Investments in Debt and Equity Securities*.” EITF 03-1 specifies that an impairment would be considered other-than-temporary unless (a) the investor has the ability and intent to hold an investment for a reasonable period of time sufficient for the recovery of the fair value up to (or beyond) the cost of the investment and (b) evidence indicating the cost of the investment is recoverable within a reasonable period of time outweighs evidence of the contrary. EITF 03-1 is effective for reporting periods ending after June 15, 2004 except for the measurement and recognition provisions relating to debt and equity securities which had been deferred. The disclosure requirements continue to be effective in annual financial statements for fiscal years ending after June 15, 2004. We adopted the disclosure provisions during the period ended June 30, 2004. The guidance for measurement and recognition provisions has subsequently been replaced by SFAS No. 115-1 and SFAS No. 124-1 “*The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*” which is effective for reporting periods beginning after December 15, 2005. The Company adopted the requirements beginning January 1, 2006 which had no affect on the Consolidated Financial Statements, result of operations or liquidity of the Company.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

Fair Value Measurements

In September 2006, the FASB issued FAS No. 157, “Fair Value Measurements” (“FAS No. 157”), which establishes a framework for measuring fair value in accordance with Generally Accepted Accounting Principles (“GAAP”) and expands disclosures about fair value measurements. This statement is effective as of the beginning of the entity’s first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of FAS No. 157 will have on its consolidated financial statements.

In February 2007, the FASB issued FAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115” (“FAS No. 159”). This statement permits entities to choose to measure many financial assets and liabilities and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is effective as of the beginning of the entity’s first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of FAS No. 159 will have on its consolidated financial statements.

Business Combinations

In December 2007, the FASB issued FAS No. 141R, “Business Combinations” (“FAS No. 141R”). FAS No. 141R requires the acquiring entity to recognize the assets acquired, the liabilities assumed and any non-controlling interest in the acquiree at the acquisition date, measured at the fair values as of that date. Goodwill is measured as a residual of the fair values at acquisition date. Acquisition related costs are recognized separately from the acquisition. This statement is effective as of the beginning of the first fiscal year that begins after December 15, 2008. The Company is currently evaluating the impact, if any, of the adoption of FAS No. 141R will have on its consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**2. RECENTLY ISSUED ACCOUNTING STANDARDS (continued)***Non-controlling Interests*

In December 2007, the FASB issued FAS No. 160, "Non-controlling Interests in Consolidated Financial Statements" ("FAS No. 160"). FAS No. 160 requires non-controlling interests in a subsidiary be reported as equity in the consolidated financial statements, the attributable net income be identified and presented on the face of the consolidated statement of income and changes in the ownership be accounted for consistently. The statement also includes requirements when an interest is deconsolidated. Disclosure should be sufficient to clearly identify and distinguish between the interests of the reporting entity and that of the non-controlling interests owners. This statement is effective as of the beginning of the first fiscal year that begins after December 15, 2008. The Company is currently evaluating the impact, if any, of the adoption of FAS No. 160 will have on its consolidated financial statements.

3. CHANGE IN ACCOUNTING METHOD FOR PRENEED SELLING COSTS

On June 30, 2005, the Company changed its method of accounting for preneed selling costs, incurred for the origination of prearranged funeral and cemetery service and merchandise sales contracts. The Company has applied this change in accounting method effective January 1, 2005. Therefore, the Company's results of operations for the year ended December 31, 2005, 2006 and 2007 are reported on the basis of the changed method. 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.

As of January 1, 2005, the Company recorded the cumulative effect of the change in accounting method in the amount of \$35.8 million pretax or \$22.8 million after tax (net of income tax benefit of \$13.0 million), or \$1.24 per diluted share, which represents the cumulative balance of deferred preneed selling costs in the Company's consolidated balance sheet at that date.

4. CHANGE IN ACCOUNTING FOR INCOME TAX UNCERTAINTIES

In June 2006, FASB issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes how tax benefits for uncertain tax positions are to be recognized, measured, and derecognized in financial statements; requires certain disclosures of uncertain tax matters; specifies how reserves for uncertain tax position should be classified on the balance sheet; and provides transition and interim period guidance, among other provisions. FIN 48 is effective for fiscal years beginning after December 15, 2006 and was adopted by the Company at the beginning of the first quarter of 2007. The Company has reviewed its income tax positions and identified certain tax deductions, primarily related to business acquisitions that are not certain. The cumulative effect of adopting FIN 48 has been recorded as a reduction to the 2007 opening balance of Retained Earnings and an increase in noncurrent liabilities in the amount of \$0.2 million to the January 1, 2007 retained earnings balance.

The Company has unrecognized tax benefits for Federal and state income tax purposes totaling \$6.0 million as of December 31, 2007, resulting from deductions totaling \$15.2 million on Federal returns and \$13.4 million on various state returns. The effect of applying FIN 48 for the year ended December 31, 2007 was not material to operations. The Company has federal and state net operating loss carryforwards exceeding these deductions, and has accounted for these unrecognized tax benefits by reducing the net operating loss carryforwards by the amount of these unrecognized deductions. In certain states without net operating loss carryforwards, the Company has previously reduced its taxes payable by deductions that are not considered more likely than not. The cumulative effect of adopting FIN 48 specifically relates to those state income tax returns. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	December 31, 2007
Unrecognized tax benefit at beginning of year	\$ 4,962
Additions based on tax positions related to the current year	637
Additions for tax positions of prior years	504
Reductions as a result of a lapse of the applicable statute of limitations	(86)
Unrecognized tax benefit at end of year	<u>\$ 6,017</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. CHANGE IN ACCOUNTING FOR INCOME TAX UNCERTAINTIES (continued)

The entire balance of unrecognized tax benefits, if recognized, would affect the Company's effective tax rate. The Company does not anticipate a significant increase or decrease in its unrecognized tax benefits during the next twelve months. The amount of penalty and interest recognized in the balance sheet and statement of operations was not material for the year ended December 31, 2007. The Company's policy with respect to potential penalties and interest is to record them as "other" expense and interest expense, respectively.

The Company's Federal income tax returns for 2001 through 2007 are open tax years that may be examined by the Internal Revenue Service. The Company's unrecognized state tax benefits are related to state returns open from 2001 through 2007.

5. ACQUISITIONS

Our growth strategy includes the execution of the Strategic Portfolio Optimization Model. The goal of that model is to build concentrated groups of businesses in ten to fifteen strategic markets. We assess acquisition candidates using six strategic ranking criteria and to differentiate the pricing we are willing to pay. Those criteria are:

- Size of business
- Size of market
- Competitive standing
- Demographics
- Strength of brand
- Barriers to entry

During 2007, the Company completed seven acquisitions. The consideration paid for those businesses was cash. We have not incurred any debt to buy these businesses. The Company acquired substantially all the assets and assumed certain operating liabilities including obligations associated with existing preneed contracts. The assets and liabilities were recorded at fair value and included goodwill. The results of the acquired business are included in the Company's results from the date of acquisition. The proforma impact of the acquisition on the prior period is not presented as the impact is not material to reported results. Selected information on the acquisitions follows:

Acquisition Date	Type of Business	Market	Assets Acquired (Excluding Goodwill)	Goodwill Recorded	Liabilities Assumed
January 2007	Combination and Funeral Home	Corpus Christi, TX	\$ 27.7	\$ 4.1	\$ 25.4
April 2007	Combination	Los Angeles, CA	\$ 13.0	—	\$ 4.8
June 2007	Combination and Cemetery	Boise, ID	\$ 8.7	6.1	\$ 4.9
June 2007	Funeral Home	Santa Fe, NM	\$ 0.9	—	—
August 2007	Five Funeral Homes	Springfield, MA	\$ 5.1	0.3	\$ 1.7
November 2007	Four Funeral Homes	Los Angeles, CA	\$ 6.4	4.0	\$ 0.2
November 2007	Funeral Home	Methuen, MA	\$ 5.5	4.0	\$ 3.6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. ACQUISITIONS (continued)

The effect of the acquisitions on the consolidated balance sheet at December 31, 2007 was as follows (in thousands):

Current assets	\$ 2,072
Property, plant & equipment	33,203
Goodwill	18,532
Preneed assets	32,643
Deferred charges	1,635
Current Liabilities	(6,958)
Debt	(1,069)
Deferred preneed revenues	(11,128)
Non-controlling interest in trusts	(24,715)
Cash used for acquisition	\$ 44,215
Unassumed liabilities	3,573
Debt paid at acquisition	816
	<u>\$ 48,604</u>

6. ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

The Company continually reviews locations to optimize the sustainable earning power and return on invested capital of the Company. The Company's strategy, the Strategic Portfolio Optimization Model, uses strategic ranking criteria to also assess disposition candidates. The execution of this strategy entails selling generally non-strategic businesses.

In 2007, the Company sold four funeral home businesses for approximately \$3.2 million and recognized a gain of \$1.2 million. During 2006, the Company recorded impairment charges totaling \$2.1 million, which is related to specifically identified goodwill, for one of these businesses.

During 2006, the Company sold a funeral home business and a combination funeral home and cemetery business for approximately \$6.5 million and ceased operations at a funeral home business. The Company recorded impairment charges of \$6.3 million, a substantial portion of which related to specifically identified goodwill, and recognized \$0.2 million of net losses.

During 2005, the Company sold a funeral home business and a cemetery business for cash proceeds totaling \$1.6 million and ceased operations at a funeral home business. The transactions generated gains of approximately \$1.3 million.

No businesses were held for sale at December 31, 2007. At December 31, 2006, assets and liabilities associated with the three funeral home businesses held for sale in the accompanying balance sheet consisted of the following (in thousands).

	December 31, 2006
Assets:	
Current assets	\$ 124
Property, plant and equipment, net	1,406
Preneed receivables and trust investments	634
Goodwill	324
Deferred charges and other assets	146
Total	<u>\$ 2,634</u>
Liabilities:	
Current liabilities	\$ 229
Deferred preneed funeral contracts revenue	78
Senior long-term debt, net of current portion	54
Non-controlling interests in funeral and cemetery trust investments	700
Total	<u>\$ 1,061</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

6. ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS (continued)

The operating results of businesses discontinued during the periods presented, as well as impairments and gains or losses on the disposal, are presented in the discontinued operations section of the consolidated statements of operations, along with the income tax affect. Likewise, the operating results, impairment charges and gains or losses from those businesses have been similarly reported for comparability. The results for the businesses presented in the discontinued operations section are as follows (in thousands):

	For the years ended December 31,		
	2005	2006	2007
Revenues	\$ 7,244	\$ 4,447	\$ 628
Operating income (loss)	\$ 1,742	\$ 853	\$ (8)
Gain (losses) on sale and (impairments)	1,303	(8,614)	1,214
(Provision) benefit for income taxes	(1,033)	2,631	(452)
Income (loss) from discontinued operations	<u>\$ 2,012</u>	<u>\$ (5,130)</u>	<u>\$ 754</u>

7. SHORT TERM INVESTMENTS

Short term investments are investments purchased with an original maturity of greater than three months but less than a year at the time of purchase. Short term investments at December 31, 2006 consisted of commercial paper with maturity dates that ranged from January 2007 to February 2007 at rates ranging from 5.17 % to 5.19 % per annum. Market value approximated cost. There were no short term investments at December 31, 2007.

8. GOODWILL

Many of the acquired funeral homes and former owners have provided high quality service to families for generations. The resulting loyalty often represents a substantial portion of the value of a funeral business. 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.

The following table presents changes in goodwill for the year ended December 31, 2006 and 2007 (in thousands):

	December 31, 2006	December 31, 2007
Goodwill at beginning of year	\$ 157,358	\$ 148,845
Impairments	(8,392)	—
Divestitures	(121)	(114)
Acquisitions	—	18,532
Goodwill at end of year	<u>\$ 148,845</u>	<u>\$ 167,263</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. PRENEED TRUST INVESTMENTS

Preneed cemetery trust investments

Preneed cemetery trust investments represent trust fund assets that the Company will withdraw when the merchandise or services are provided. The cost and market values associated with preneed cemetery trust assets at December 31, 2007 are detailed below (in thousands). The Company believes the unrealized losses related to trust investments are temporary in nature.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and short-term investments	\$ 5,001	\$ —	\$ —	\$ 5,001
Fixed income securities:				
U.S. Agency obligations	18,645	412	(2)	19,055
State obligations	351	13	—	364
Corporate	1,950	36	(10)	1,976
Other	5	—	—	5
Common Stock	12,881	1,343	(883)	13,341
Mutual funds:				
Equity	14,155	1,349	(211)	15,293
Fixed income	5,887	100	(230)	5,757
Trust investments	<u>\$ 58,875</u>	<u>\$ 3,253</u>	<u>\$ (1,336)</u>	<u>\$ 60,792</u>
Accrued investment income	<u>\$ 322</u>			<u>\$ 322</u>
Trust assets				<u>\$ 61,114</u>
Market value as a percentage of cost				<u>103.8%</u>

The estimated maturities of the fixed income securities included above are as follows:

Due in one year or less	\$ 1,938
Due in one to five years	14,587
Due in five to ten years	4,712
Thereafter	163
	<u>\$ 21,400</u>

The cost and market values associated with preneed cemetery trust assets at December 31, 2006 are detailed below (in thousands).

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and short-term investments	\$ 4,559	\$ —	\$ —	\$ 4,559
Fixed income securities:				
U.S. Agency obligations	13,544	3	(89)	13,458
State obligations	5,811	66	(155)	5,722
Corporate	2,426	17	(19)	2,424
Other	6	—	—	6
Common Stock	10,074	1,582	(60)	11,596
Mutual funds:				
Equity	11,192	1,305	(155)	12,342
Fixed income	5,061	83	(16)	5,128
Trust investments	<u>\$ 52,673</u>	<u>\$ 3,056</u>	<u>\$ (494)</u>	<u>\$ 55,235</u>
Accrued investment income	<u>\$ 248</u>			<u>\$ 248</u>
Trust assets				<u>\$ 55,483</u>
Market value as a percentage of cost				<u>105.3%</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. PRENEED TRUST INVESTMENTS (continued)

Preneed Funeral Trust Investments

Preneed funeral trust investments represent trust fund assets that the Company expects to withdraw when the services and merchandise are provided.

The cost and market values associated with preneed funeral trust assets at December 31, 2007 are detailed below (in thousands). The Company believes the unrealized losses related to trust investments are temporary in nature.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and other short-term investments	\$ 35,665	\$ —	\$ —	\$ 35,665
Fixed income securities:				
U.S. Treasury	7,330	212	—	7,542
State obligations	1,581	46	—	1,627
Corporate	1,790	29	(9)	1,810
Obligations and guarantees of U.S. government agencies	1,583	36	(1)	1,618
Common Stock	4,239	624	(73)	4,790
Mutual funds:				
Equity	11,192	1,333	(82)	12,443
Fixed income	2,823	27	(53)	2,797
Trust investments	<u>\$ 66,203</u>	<u>\$ 2,307</u>	<u>\$ (218)</u>	<u>\$ 68,292</u>

Market value as a percentage of cost	<u>103.2%</u>
--------------------------------------	---------------

The estimated maturities of the fixed income securities included above are as follows:

Due in one year or less	\$ 3,443
Due in one to five years	8,928
Due in five to ten years	226
Thereafter	0
	<u>\$ 12,597</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. PRENEED TRUST INVESTMENTS (continued)

The cost and market values associated with preneed funeral trust assets at December 31, 2006 are detailed below (in thousands).

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and other short-term investments	\$ 15,865	\$ —	\$ —	\$ 15,865
Fixed income securities:				
U.S. Treasury	7,811	25	(7)	7,829
State obligations	1,678	53	—	1,731
Corporate	2,186	31	(16)	2,201
Obligations and guarantees of U.S. government agencies	1,075	3	(16)	1,062
Common Stock	2,301	590	—	2,891
Mutual funds:				
Equity	8,598	1,169	(25)	9,742
Fixed income	3,278	263	(11)	3,530
Trust investments	<u>\$ 42,792</u>	<u>\$ 2,134</u>	<u>\$ (75)</u>	<u>\$ 44,851</u>

Market value as a percentage of cost 104.8%

Upon cancellation of a preneed funeral or cemetery contract, a customer is generally entitled to receive a refund of the corpus and some or all of the earnings held in trust. In certain jurisdictions, the Company is obligated to fund any shortfall if the amounts deposited by the customer exceed the funds in trust including some or all investment income. As a result, when realized or unrealized losses of a trust result in the trust being under-funded, the Company assesses whether it is responsible for replenishing the corpus of the trust, in which case a loss provision would be recorded. No loss amounts have been required to be recognized for the periods presented in the Consolidated Financial Statements.

Trust Investment Security Transactions

Cemetery and funeral trust investment security transactions recorded in Other income in the Consolidated Statements of Operations for the years ended December 31, 2006 and 2007 are as follows (in thousands):

	December 31, 2006	December 31, 2007
Investment income	\$ 2,913	\$ 4,615
Realized gains	3,433	4,129
Realized losses	(1,273)	(410)
Expenses	(1,126)	(1,191)
Increase in non-controlling interests in trust investments	(3,947)	(7,143)
	<u>\$ —</u>	<u>\$ —</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. RECEIVABLES FROM PRENEED FUNERAL TRUSTS

The receivables from funeral trusts at December 31, 2006 and 2007 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.

The components of the receivables from funeral trusts in the consolidated balance sheet at December 31, 2006 and 2007 are as follows (in thousands):

	December 31, 2006	December 31, 2007
Amount due from preneed funeral trust funds	\$ 17,427	\$ 16,717
Less: allowance for contract cancellation	(1,778)	(1,705)
	<u>\$ 15,649</u>	<u>\$ 15,012</u>

The following summary reflects the composition of the assets held in trust and controlled by third parties to satisfy Carriage's future obligations under preneed funeral arrangements related to the preceding contracts at December 31, 2007 and 2006. The cost basis includes reinvested interest and dividends that have been earned on the trust assets. Fair value includes unrealized gains and losses on trust assets.

	Historical Cost Basis (in thousands)	Fair Value
As of December 31, 2007:		
Cash and cash equivalents	\$ 2,916	\$ 2,916
Fixed income investments	10,576	10,341
Mutual funds and common stocks	100	100
Annuities	3,125	3,298
Total	<u>\$ 16,717</u>	<u>\$ 16,655</u>
As of December 31, 2006:		
Cash and cash equivalents	\$ 2,658	\$ 2,658
Fixed income investments	11,607	11,079
Mutual funds and common stocks	109	108
Annuities	3,053	3,296
Total	<u>\$ 17,427</u>	<u>\$ 17,141</u>

11. CONTRACTS SECURED BY INSURANCE

Certain preneed funeral contracts are secured by life insurance policies. Generally, 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 totaled \$161.1 and \$191.7 million at December 31, 2006 and 2007, respectively and are not recorded on the Company's balance sheet.

12. 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 Company has consolidated the perpetual care trust funds with a corresponding amount as Non-controlling interests in perpetual care trusts. Realized and distributable earnings from these perpetual care trust investments are recognized in current cemetery revenues and are used to defray cemetery maintenance costs which are expensed as incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

12. CEMETERY PERPETUAL CARE TRUST INVESTMENTS (continued)

The cost and market values associated with the trust investments held in perpetual care trust funds at December 31, 2007 are detailed below (in thousands). The Company believes the unrealized losses related to the trust investments are temporary in nature.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and other short-term investments	\$ 2,785	\$ —	\$ —	\$ 2,785
Fixed income securities:				
U.S. Agency obligation	6,448	99	(2)	6,545
State obligations	489	18	—	507
Corporate	901	40	(1)	940
Other	293	—	(3)	290
Common Stock	11,698	1,174	(903)	11,969
Mutual funds:				
Equity	7,812	892	(273)	8,431
Fixed income	5,785	92	(239)	5,638
Other assets				
Trust investments	<u>\$ 36,211</u>	<u>\$ 2,315</u>	<u>\$ (1,421)</u>	<u>\$ 37,105</u>
Accrued investment income	<u>\$ 97</u>			<u>\$ 97</u>
Trust assets				<u>\$ 37,202</u>
Market value as a percentage of cost				<u>102.7%</u>
The estimated maturities of the fixed income securities included above are as follows:				
Due in one year or less				\$ 1,191
Due in one to five years				5,302
Due in five to ten years				1,535
Thereafter				254
				<u>\$ 8,282</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

12. CEMETERY PERPETUAL CARE TRUST INVESTMENTS (continued)

The cost and market values associated with the trust investments held in perpetual care trust funds at December 31, 2006 are detailed below (in thousands). The Company believes the unrealized losses related to the trust investments are temporary in nature.

	Cost	Unrealized Gains	Unrealized Losses	Market
Cash, money market and other short-term investments	\$ 1,542	\$ —	\$ —	\$ 1,542
Fixed income securities:				
U.S. Treasury	499	4	(3)	500
U.S. Agency obligation	6,444	3	(61)	6,386
State obligations	609	15	—	624
Corporate	1,049	22	(2)	1,069
Other	363	—	(10)	353
Common Stock	9,104	1,678	(63)	10,719
Mutual funds:				
Equity	5,660	858	(132)	6,386
Fixed income	4,737	110	(6)	4,841
Other assets	—	—	—	—
Trust investments	<u>\$ 30,007</u>	<u>\$ 2,690</u>	<u>\$ (277)</u>	<u>\$ 32,420</u>
Accrued investment income	<u>\$ 120</u>			<u>\$ 120</u>
Trust assets				<u>\$ 32,540</u>
Market value as a percentage of cost				<u>108.4%</u>

Non-controlling interests in cemetery perpetual care trusts represent the corpus of those trusts plus undistributed income. The components of non-controlling interests in cemetery perpetual care trusts as of December 31, 2006 and 2007 are as follows:

	December 31, 2006	December 31, 2007
Trust assets, at market value	\$ 32,540	\$ 37,202
Pending withdrawals of income	(1,351)	(901)
Non-controlling interests	<u>\$ 31,189</u>	<u>\$ 36,301</u>

Trust Investment Security Transactions

Perpetual care trust investment security transactions recorded in Other income in the Consolidated Statements of Operations for the year ended December 31, 2006 and 2007 are as follows (in thousands):

	December 31, 2006	December 31, 2007
Undistributable realized gains	\$ 1,010	\$ 1,734
Undistributable realized losses	(363)	(62)
Increase in non-controlling interests in perpetual care trust investments	(647)	(1,672)
	<u>\$ —</u>	<u>\$ —</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

13. DEFERRED CHARGES AND OTHER NON-CURRENT ASSETS

Deferred charges and other non-current assets at December 31, 2006 and 2007 were as follows:

	December 31, 2006	December 31, 2007
	(in thousands)	
Prepaid agreements not to compete, net of accumulated amortization of \$4,092 and \$4,259, respectively	\$ 511	\$ 1,039
Deferred loan costs, net of accumulated amortization of \$1,083 and \$1,663, respectively	4,012	3,433
Deferred tax asset	16,540	7,133
Federal agency bond (cost approximates market)	5,000	—
Other	4,396	4,797
	<u>\$ 30,459</u>	<u>\$ 16,402</u>

Agreements not to compete are amortized over the term of the respective agreements, ranging from four to ten years. Deferred loan costs are being amortized over the term of the related debt.

14. LONG-TERM DEBT

Long-Term Debt

The Company's long-term debt consisted of the following at December 31, 2006 and 2007:

	December 31, 2006	December 31, 2007
	(in thousands)	
Credit Facility, secured floating rate \$35 million line matures in April, 2010	\$ —	\$ —
7.875% Senior Notes due 2015	130,000	130,000
Acquisition debt	2,669	1,421
Other	2,731	2,768
Less: current portion	(1,559)	(1,195)
	<u>\$ 133,841</u>	<u>\$ 132,994</u>

The Company has a \$35 million senior secured revolving credit facility. Borrowings under the credit facility bear interest at prime or LIBOR options with the current LIBOR option set at LIBOR plus 275 basis points. Interest is payable quarterly. The credit facility is collateralized by all personal property and funeral home real property in certain states. The facility is currently undrawn.

In accordance with the terms of the Company's credit facility, a portion of the cash proceeds from the sale of funeral home and cemetery businesses are pledged to the benefit of the lenders and are restricted for use only for acquisitions of similar businesses, capital expenditures, or paydowns of debt. During 2006, approximately \$5.5 million of such proceeds were so pledged, with \$2.6 million released during 2006 and the remainder released in 2007.

Carriage, the parent entity, has no material assets or operations independent of its subsidiaries. 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 7.875% 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 Senior Notes.

In connection with the issuance of the Senior Notes in 2005, the Company made a required "make whole" payment of \$6.0 million (recorded as additional interest) to the holders of debt that was paid off early from the Senior Notes 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). In connection with the placement of the senior secured revolving credit facility also in 2005, the Company recorded a charge to write off \$0.2 million or \$0.01 per diluted share of unamortized loan costs related to the previous credit facility.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

14. LONG-TERM DEBT (continued)

The Company was in compliance with the covenants contained in the credit facility and the Senior Notes as of and for the years ended December 31, 2006 and 2007.

Acquisition debt consists of deferred purchase prices payable to sellers. The deferred purchase price notes bear interest at 0%, discounted at imputed interest rates ranging from 6% to 8%, with original maturities from three to 15 years.

The aggregate maturities of long-term debt for the next five years as of December 31, 2007 are approximately \$1,195,000, \$661,000, \$396,000, \$418,000 and \$422,000, respectively and \$131,097,000 thereafter.

15. CONVERTIBLE JUNIOR SUBORDINATED DEBENTURE PAYABLE TO AFFILIATE AND COMPANY OBLIGATED MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED SECURITIES OF CARRIAGE SERVICES CAPITAL TRUST

Carriage's wholly-owned subsidiary, Carriage Services Capital Trust, issued 1,875,000 units of 7% convertible preferred securities (TIDES) during June 1999, resulting in approximately \$90 million in net proceeds, and the Company issued a 7% convertible junior subordinated debenture to the Trust in the amount of \$93.75 million. The convertible preferred securities have a liquidation amount of \$50 per unit, and are convertible into Carriage's Common Stock at the equivalent conversion price of \$20.4375 per share of Common Stock. The subordinated debentures and the TIDES mature in 2029 and the TIDES are guaranteed on a subordinated basis by the Company. Both the subordinated debentures and the TIDES contain a provision for the deferral of distributions for up to 20 consecutive quarters. During the period in which distribution payments are deferred, distributions will continue to accumulate at the 7 percent annual rate. Also, the deferred distributions will themselves accumulate distributions at the annual rate of 7 percent. During the period in which distributions are deferred, Carriage is prohibited from paying dividends on its common stock or repurchasing its common stock, with limited exceptions. The Company deferred the distributions during the period September 2003 to January 2005. The Company brought the deferred distributions current during January 2005. There are no deferred distributions at December 31, 2007.

16. COMMITMENTS AND CONTINGENCIES

Leases

Carriage leases certain office facilities, vehicles and equipment under operating leases for terms ranging from one to 15 years. Certain of these leases provide for an annual adjustment and contain options for renewal. Rent expense totaled \$3,805,000, \$3,735,000 and \$3,704,000 for 2005, 2006 and 2007, respectively. Assets acquired under capital leases are included in property, plant and equipment in the accompanying consolidated balance sheets in the amount of \$1,387,000 in 2006 and \$1,323,000 in 2007, net of accumulated depreciation. Capital lease obligations are included in current and long-term debt as indicated below.

At December 31, 2007, future minimum lease payments under noncancellable lease agreements were as follows:

	Future Minimum Lease Payments	
	Operating Leases	Capital Leases
	(in thousands)	
Years ending December 31,		
2008	\$ 2,248	\$ 626
2009	1,609	643
2010	1,226	650
2011	939	650
2012	909	666
Thereafter	3,455	6,983
Total future minimum lease payments	\$ 10,386	\$ 10,218
Less: amount representing interest (rates ranging from 7% to 11.5%)		(5,494)
Less: current portion of obligations under capital leases		(61)
Long-term obligations under capital leases		\$ 4,663

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**16. COMMITMENTS AND CONTINGENCIES (continued)***Agreements and Employee Benefits*

Carriage has obtained various agreements not to compete from former owners and employees. These agreements are generally for one to 10 years and provide for periodic payments over the term of the agreements. The aggregate payments due under these agreements for the next five years total \$1,032,000, \$669,000, \$533,000, \$317,000 and \$258,000, respectively and \$447,000 thereafter.

The Company has entered into various consulting agreements with former owners of businesses. Payments for such agreements are generally not made in advance. These agreements are generally for one to 10 years and provide for future payments monthly or bi-weekly. The aggregate payments for the next five years total \$430,000, \$246,000, \$95,000, \$33,000 and \$23,000, respectively and \$50,000 thereafter.

The Company has entered into employment agreements with the executive officers and management. These agreements are generally for two to five years and provide for participation in various incentive compensation arrangements. The payments due under these agreements for the next three years total \$2,270,000, \$2,225,000 and \$1,412,000, respectively.

Carriage sponsors a defined contribution plan (401k) for the benefit of its employees. The Company's matching contributions and plan administrative expenses totaled \$268,000, \$217,000 and \$650,000 for 2005, 2006 and 2007, respectively. The Company does not offer any post-retirement or post-employment benefits.

Other Commitments

In 2005, the Company entered into an agreement to outsource the processing of transactions for the cemetery business. The Company and the contractor may terminate the contract for various reasons upon written notification and set terms. Payments vary based on the level of resources provided. The Company paid \$1.2 million, \$2.2 million and \$1.7 million to the contractor for services in 2005, 2006 and 2007, respectively.

Litigation

We are a party to various litigation matters and proceedings. For each of our outstanding legal matters, we evaluate the merits of the case, our exposure to the matter, possible legal or settlement strategies, and the likelihood of an unfavorable outcome. We intend to defend ourselves in the lawsuits described herein; however, if we determine that an unfavorable outcome is probable and can be reasonably estimated, we establish the necessary accruals. We hold certain insurance policies that may reduce cash outflows with respect to an adverse outcome of certain of these litigation matters.

Spencer Cranney, et al., v. Carriage Services, Inc., et al., United States District Court, District of Nevada, Case No. 2:07-cv-01587— On November 28, 2007, five former Funeral Directors filed suit for themselves and on behalf of all hourly, non-exempt employees of Carriage in the United States District Court for the District of Nevada. Plaintiffs allege violations of state wage and hour laws and the federal Fair Labor Standards Act (FLSA), as well as related tort and contract claims. Specifically, Plaintiffs allege that Carriage failed to properly compensate employees for time spent on community work, on-call time, pre-need appointments, and training, failed to provide required meal and rest breaks under California state law, and failed to maintain proper records. Carriage filed its Answer to the Complaint on January 28, 2008, denying all material allegations and asserting appropriate affirmative defenses. On February 29, 2008, the Court granted Plaintiffs' motion for conditional certification under the FLSA. The parties currently are in the process of effectuating notice of the lawsuit to all potential class members pursuant to the Court's order. The Company will defend this lawsuit vigorously. Because the lawsuit is in its preliminary stages, we are unable to evaluate the likelihood of an unfavorable outcome to the Company or to estimate the amount or range of any potential loss, if any, at this time.

Means v. Carriage Cemetery Services, Inc., et al., Indiana Superior Court, Marion County, Indiana, Case No. 49D12-0704-PL-016504. On April 20, 2007, Plaintiff Cecilia Means ("Plaintiff") filed a putative class action alleging that one or more of the current and past owners of Grandview Cemetery in Madison, Indiana—including the Carriage subsidiaries that owned the cemetery from January 1997 until February 2001—and one or more of the bank trustees who served as trustee of Grandview Cemetery's Pre-Arrangement Trust Fund (the "Grandview Trust Fund"), improperly withdrew funds from the Grandview Trust Fund. Carriage denies all material allegations because the subject withdrawals occurred in a period other than during Carriage's ownership, and filed a motion for summary judgment with respect to Plaintiff's claims against it. The Court has yet to rule on either motion. Plaintiff has also filed a motion to certify a class, and briefing on this issue is ongoing. The Company will defend this action vigorously. Because the lawsuit is in its preliminary stages, we are unable to evaluate the likelihood of an unfavorable outcome to the Company or to estimate the amount or range of any potential loss, if any, at this time.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

16. COMMITMENTS AND CONTINGENCIES (continued)

Leathermon, et al. v. Grandview Memorial Gardens, Inc., et al., United States District Court, Southern District of Indiana, Case No. 4:07-cv-137. On August 17, 2007, five plaintiffs (“Plaintiffs”) filed a putative class action against the current and past owners of Grandview Cemetery in Madison, Indiana—including the Carriage subsidiaries that owned the cemetery from January 1997 until February 2001—on behalf of all individuals who purchased cemetery and burial goods and services at Grandview Cemetery. Plaintiffs claim that the cemetery owners performed burials negligently, breached plaintiffs’ contracts, and made misrepresentations regarding the cemetery. On October 15, 2007, the case was removed from Jefferson County Circuit Court, Indiana to the Southern District of Indiana. The Company has filed its answer denying the claims and will defend this action vigorously. Because the lawsuit is in its preliminary stages, we are unable to evaluate the likelihood of an unfavorable outcome to the Company or to estimate the amount or range of any potential loss, if any, at this time.

Kendall v. Carriage Funeral Holdings, Inc., et al., Indiana Circuit Court, Jefferson County, Indiana, Case No. 39C01-0707-CT-386 (filed July 27, 2007); *Lapine Hillard, et al. v. Carriage Funeral Holdings, Inc., et al.*, Indiana Circuit Court, Jefferson County, Case No. 39C01-0708-CT-398 (filed August 7, 2007); *Lawson v. Carriage Funeral Holdings, Inc.*, Indiana Circuit Court, Jefferson County, Indiana, Case No. 39C01-0708-CT-429 (filed August 17, 2007); *Wiley, et al. v. Carriage Funeral Holdings, Inc., et al.*, Indiana Circuit Court, Jefferson County, Indiana, Case No. 39C01-0706-CT-287 (filed June 6, 2007). In these individual actions, Plaintiffs allege improper handling of remains or improper burial practices by Vail-Holt Funeral Home in Madison, Indiana and/or Grandview Memorial Gardens, Inc. Carriage has denied these allegations because these burials all occurred before Carriage owned Grandview Cemetery and Vail-Holt Funeral Home. Carriage has moved to dismiss Plaintiffs’ claims with respect to the funeral home because, among other reasons, Carriage assumed only Vail-Holt’s assets, and not its liabilities, under the Asset Purchase Agreement. Carriage has also moved to dismiss certain claims with respect to Grandview Cemetery because Plaintiffs released Grandview Cemetery from contractual liability pursuant to an exculpatory clause. The court has not yet ruled on Carriage’s motions. The Company will defend these actions vigorously. Because the lawsuit is in its preliminary stages, we are unable to evaluate the likelihood of an unfavorable outcome to the Company or to estimate the amount or range of any potential loss, if any, at this time.

17. INCOME TAXES

The provision (benefit) for income taxes from continuing operations for the year ended December 31, 2005, 2006 and 2007 consisted of:

	Year Ended December 31,		
	2005	2006	2007
	(in thousands)		
Current:			
U. S. Federal	\$ —	\$ 227	\$ (7)
State	241	491	439
Total current provision	241	718	432
Deferred:			
U. S. Federal	(373)	1,975	4,418
State	(400)	(388)	218
Total deferred provision (benefit)	(773)	1,587	4,636
Total income tax provision (benefit)	\$ (532)	\$ 2,305	\$ 5,068

A reconciliation of taxes calculated at the U.S. Federal statutory rate to those reflected in the consolidated statements of operations for the year ended December 31, 2005, 2006 and 2007 is as follows:

	Year Ended December 31,					
	2005		2006		2007	
	Amount	Percent	Amount	Percent	Amount	Percent
Federal statutory rate	\$ (564)	34.0%	\$ 2,051	34.0%	\$ 4,282	34.0%
Effect of state income taxes, net of Federal benefit	(41)	2.5	462	7.7	954	7.6
Effect of non-deductible expenses and other, net	214	(14.7)	101	1.6	(109)	(0.9)
Change in valuation allowance	(141)	9.7	(309)	(5.0)	(59)	(0.5)
	<u>\$ (532)</u>	<u>31.5%</u>	<u>\$ 2,305</u>	<u>38.3%</u>	<u>\$ 5,068</u>	<u>40.2%</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

17. INCOME TAXES (continued)

The tax effects of temporary differences that give rise to significant deferred tax assets and liabilities at December 31, 2006 and 2007 were as follows:

	<u>Year Ended December 31,</u>	
	<u>2006</u>	<u>2007</u>
	(in thousands)	
Deferred income tax assets:		
Net operating loss carryforwards	\$ 5,927	\$ 5,635
Minimum tax credit carryforwards	—	144
State tax credit carryforwards	—	109
Accrued liabilities and other	1,672	1,721
Amortization of non-compete agreements	1,813	1,302
Preneed liabilities, net	23,320	24,700
Total deferred income tax assets	32,732	33,611
Less valuation allowance	(823)	(1,955)
Total deferred income tax assets	<u>\$ 31,909</u>	<u>\$ 31,656</u>
Deferred income tax liabilities:		
Amortization and depreciation	\$ (13,697)	\$ (20,237)
Other	—	(314)
Total deferred income tax liabilities	<u>(13,697)</u>	<u>(20,551)</u>
Total net deferred tax assets	<u>\$ 18,212</u>	<u>\$ 11,105</u>
Current deferred tax asset	\$ 1,672	\$ 3,972
Non-current deferred tax asset	16,540	7,133
Total net deferred tax assets	<u>\$ 18,212</u>	<u>\$ 11,105</u>

The current deferred tax asset is included in Inventories and other current assets at December 31, 2006 and 2007. The non-current deferred tax asset is included in deferred charges and other non-current assets at December 31, 2006 and 2007.

Carriage 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. The Company increased its valuation allowance and recorded deferred tax liabilities in the amounts of \$1.1 million (equal to \$0.06 per diluted share) during 2007. The increase was primarily due to the Company increasing its blended state statutory rate from 3.8% to 6.8%. This increase was offset by a corresponding increase in the Company's state net operating loss carryforward deferred tax asset.

For federal income tax reporting purposes, Carriage has net operating loss carryforwards totaling \$6.6 million available at December 31, 2007 to offset future Federal taxable income, which expire between 2021 and 2025 if not utilized. Carriage also has approximately \$63.7 million of state net operating loss carryforwards that will expire between 2008 and 2027, if not utilized. Based on management's assessment of the various state net operating losses, it was determined that it is more likely than not that the Company will not be able to realize tax benefits on a substantial amount of the state losses. The valuation allowance at December 31, 2007 is attributable to the deferred tax asset related to the state operating losses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

18. STOCKHOLDERS' EQUITY

Stock Based Compensation Plans

During the three year period ended December 31, 2007 Carriage had five stock benefit plans in effect under which stock option grants or restricted stock have been issued or remain outstanding: the 1995 Stock Incentive Plan (the "1995 Plan"), the 1996 Stock Option Plan (the "1996 Plan"), the 1996 Directors' Stock Option Plan (the "Directors' Plan"), the 1998 Stock Option Plan for Consultants (the "Consultants' Plan") and the 2006 Long Term Incentive Plan (the "2006 Plan"). Substantially all of the options granted under the plans have ten-year terms. The 1995 Plan expired in 2005 and the 1996 Plan, the Director's Plan and the Consultants Plan were terminated during 2006. The expiration and termination of these plans does not affect the options previously issued and outstanding.

All stock-based plans are administered by the Compensation Committee appointed by the Board of Directors. The 2006 Plan provides for grants of options as non-qualified options or incentive stock options, restricted stock, stock appreciation rights and performance awards. Option grants are required by the 2006 Plan to be issued with an exercise price equal to or greater than the then fair market value of Carriage's Common Stock as determined by the closing price on the date of the option grant. Because of changes in the Company's compensation philosophy, options have not been awarded to officers since 2003 and only a small percentage of the outstanding options are currently unvested.

The status of each of the plans at December 31, 2007 are as follows (in thousands):

	Shares Reserved	Shares Available to Issue	Options Outstanding
1995 Plan	—	—	243
1996 Plan	—	—	548
Directors' Plan	—	—	205
2006 Plan	1,350	988	—
Total	<u>1,350</u>	<u>988</u>	<u>996</u>

Stock Options

A summary of the stock options at December 31, 2005, 2006 and 2007 and changes during the three years ended is presented in the table and narrative below:

	Year ended December 31,					
	2005		2006		2007	
	Shares (000)	Wtd. Avg. Ex Price	Shares (000)	Wtd. Avg. Ex Price	Shares (000)	Wtd. Avg. Ex Price
Outstanding at beginning of period	1,616	\$3.64	1,365	\$3.39	1,243	\$3.32
Granted	24	6.02	24	4.81	—	—
Exercised	(178)	2.99	(87)	3.01	(218)	2.83
Canceled or expired	(97)	8.93	(59)	6.06	(29)	7.45
Outstanding at end of year	<u>1,365</u>	3.39	<u>1,243</u>	3.32	<u>996</u>	3.12
Exercisable at end of year	<u>1,253</u>	3.30	<u>1,202</u>	3.28	<u>989</u>	3.11
Weighted average fair value of options granted		\$3.22		\$2.44		

Assumptions used in determining option fair values:

Expected dividend yield	0%	0%
Expected volatility	50%	58%
Risk-free interest rate	4.04%	4.25%
Expected life (years)	5	5

The aggregate intrinsic value of the outstanding and exercisable stock options at December 31, 2007 totaled \$5,851,000 and \$5,819,000 respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

18. STOCKHOLDERS' EQUITY (continued)

The total intrinsic value of options exercised during 2005, 2006 and 2007 totaled \$357,000, \$155,000 and \$1,157,000, respectively. As of December 31, 2007, there was \$17,000 of unrecognized compensation cost, net of estimated forfeitures, related to nonvested stock options, which is expected to be recognized over a weighted average period of approximately one year. Pursuant to the Company's adoption of FAS 123R on January 1, 2006, the Company recorded compensation expense totaling \$117,000 and \$36,000 in 2006 and 2007, respectively, related to the vesting of stock options.

The following table further describes the Company's outstanding stock options at December 31, 2007 (shares in thousands):

Actual Range of Exercise Prices 150% increment	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/07	Weighted- Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at 12/31/07	Weighted-Average Exercise Price
\$ 1.19-1.56	538	3.0	\$ 1.50	538	\$ 1.50
\$ 2.06-3.09	120	2.5	\$ 2.89	120	\$ 2.89
\$ 3.12-4.66	87	5.3	\$ 4.19	80	\$ 4.15
\$ 4.77-6.19	219	4.7	\$ 5.08	219	\$ 5.08
\$13.25-19.88	32	0.2	\$ 14.60	32	\$ 14.60
\$ 1.19-19.88	996	3.4	\$ 3.12	989	\$ 3.11

Employee Stock Purchase Plan

Carriage provides all employees the opportunity to purchase Common Stock through payroll deductions. Purchases are made quarterly; the price being 85% of the lower of the price on the grant date or the purchase date. In 2005, employees purchased a total of 86,354 shares at a weighted average price of \$4.20 per share. During 2006, employees purchased a total of 74,536 shares at a weighted average price of \$4.03 per share. In 2007, employees purchased a total of 79,120 shares at a weighted average price of \$4.71 per share. Pursuant to the Company's adoption of FAS 123R on January 1, 2006, compensation cost totaling approximately \$119,000 and \$95,000 was expensed in 2006 and 2007, respectively.

The fair values of the grants at the beginning of each of the years pursuant to the Company's employee stock purchase plan ("ESPP") were estimated using the following assumptions:

	2005	2006	2007
Expected dividend yield	0%	0%	0%
Expected volatility	50%	58%	24%
Risk-free interest rate	4.04%	4.25%	4.94%, 4.91%, 4.96%, 5.00%
Expected life (years)	.25, .50, .75, 1	.25, .50, .75, 1	.25, .50, .75, 1

The expected life of the ESPP grants represents the calendar quarters from the grant date (January 1) to the purchase date (end of each quarter).

Restricted Stock Grants

The Company, from time to time, issues shares of restricted common stock to certain officers and key employees of the Company from the stock benefit plans. A summary of the status of unvested restricted stock awards as of December 31, 2007, and changes during 2007, is presented below:

Unvested stock awards	Shares (in thousands)	Weighted Average Grant Date Fair Value
Unvested at January 1, 2007	248,750	\$ 4.76
Awards	318,813	7.34
Cancellations	(39,000)	6.13
Vestings	(111,500)	4.58
Unvested at December 31, 2007	417,063	6.65

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)**18. STOCKHOLDERS' EQUITY (continued)**

The Company recognized \$0.6, \$0.5 and \$0.7 million in compensation cost in 2005, 2006 and 2007, respectively, related to the vesting of restricted stock awards. As of December 31, 2007, there was \$2.1 million of total unrecognized compensation costs related to unvested restricted stock awards, which is expected to be recognized over a weighted average period of 2.7 years.

Director Compensation Plans

The Company has a compensation plan for its outside directors under which directors may choose to accept fully vested shares of the Company's common stock for all or a portion of their annual retainer and meeting fees. During the three years 2005 through 2007, the Company issued shares of common stock to directors totaling 17,088, 15,736 and 15,888, respectively, in lieu of payment in cash for their meeting fees, the market value of which was charged to operations. New directors receive an award of 20,000 shares of common stock at the time of their initial election to the Board, 50% of which are vested at the grant date and 25% of which vests on the first and second anniversary of the grant. Additionally, the non-executive officer directors received a grant of 6,000 fully vested stock options each on the date of the annual stockholders meeting during 2005 and 2006. At the 2007 annual stockholders meeting, each of the non-executive directors were granted 3,000 fully vested restricted shares from the 2006 Plan. Pursuant to the Company's adoption of FAS 123R at the beginning of 2006, the value of the 2006 and 2007 share-based compensation totaling \$140,000 and \$280,000, respectively, was charged to operations.

19. PREFERRED STOCK

The Company has 40,000,000 authorized shares of preferred stock, none of which is currently issued and outstanding.

20. RELATED PARTY TRANSACTIONS

As an incentive, the Company entered into an arrangement with a former owner, who had served as a director to pay him 10% of the amount by which the annual field level cash flow exceeds predetermined targets on certain businesses in California through 2006, with a final payment paid in 2007 equal to a multiple of six times the average of the last three years payments. The business purpose of the arrangement was to incentivise the individual to provide Carriage with high quality acquisition targets and to have input in the competitive strategies of those businesses post-acquisition so that cash flows grow over time. The terms were determined by reference to similar arrangements within the death care industry. The incentives earned by the director totaled approximately \$276,000 and \$344,000 for the years 2005 and 2006, respectively, and a final payment of \$1,452,000 paid in the first quarter of 2007.

The Company uses a law firm in which one of its partners is the spouse of the Company's Vice President and General Counsel. The firm is used for various legal matters. During the year ended December 31, 2007, the Company paid the law firm \$498,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

21. EARNINGS PER SHARE

The following table sets forth the computation of the basic and diluted earnings per share for the years ended December 31, 2005, 2006 and 2007:

	Year ended December 31,		
	2005	2006	2007
	(in thousands, except per share data)		
Numerator:			
Net income (loss) from continuing operations	\$ (1,121)	\$ 3,714	\$ 7,525
Net income (loss) from discontinued operations	2,012	(5,130)	754
Cumulative effect of change in accounting method	(22,756)	—	—
Numerator for earnings per share — net income (loss)	<u>\$ (21,865)</u>	<u>\$ (1,416)</u>	<u>\$ 8,279</u>
Denominator:			
Denominator for basic earnings per share — weighted average shares	18,334	18,545	19,020
Dilutive effect of stock options	—	367	487
Denominator for diluted earnings per share	<u>18,334</u>	<u>18,912</u>	<u>19,507</u>
Basic earnings (loss) per share:			
Continuing operations	\$ (0.06)	\$ 0.21	\$ 0.40
Discontinued operations	0.11	(0.29)	0.04
Cumulative effect of change in accounting method	(1.24)	—	—
Net income (loss)	<u>\$ (1.19)</u>	<u>\$ (0.08)</u>	<u>\$ 0.44</u>
Diluted earnings (loss) per share:			
Continuing operations	\$ (0.06)	\$ 0.20	\$ 0.39
Discontinued operations	0.11	(0.28)	0.04
Cumulative effect of change in accounting method	(1.24)	—	—
Net income (loss)	<u>\$ (1.19)</u>	<u>\$ (0.08)</u>	<u>\$ 0.43</u>

Options to purchase 1.2 million shares were not included in the computation of diluted earnings per share for the year ended December 31, 2005, because the effect would be antidilutive and 0.1 million shares because the exercise prices were greater than the average market price of the common shares.

Options to purchase 0.1 million shares were not included in the computation of diluted earnings per share for the year ended December 31, 2006, because the effect would be antidilutive as the exercise prices were greater than the average market price of the common shares.

Options to purchase 0.03 million shares were not included in the computation of diluted earnings per share for the year ended December 31, 2007, because the effect would be antidilutive as the exercise prices were greater than the average market price of the common shares.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

22. MAJOR SEGMENTS OF BUSINESS

Carriage conducts funeral and cemetery operations only in the United States. The following table presents external revenues from continuing operations, net income (loss) from continuing operations, total assets, depreciation and amortization, capital expenditures, number of operating locations, interest expense, and income tax expense (benefit) from continuing operations by segment:

	Funeral	Cemetery (in thousands, except number of operating locations)	Corporate	Consolidated
External revenues from continuing operations:				
2007	\$124,808	\$ 43,016	\$ —	\$167,824
2006	114,187	36,159	—	150,346
2005	110,882	37,555	—	148,437
Net income (loss) from continuing operations:				
2007	\$ 22,757	\$ 5,920	\$(21,152)	\$ 7,525
2006	18,811	2,540	(17,637)	3,714
2005	18,181	4,265	(23,567)	(1,121)
Total assets:				
2007	\$371,921	\$206,840	\$ 32,046	\$610,807
2006	309,140	181,225	74,631	564,996
2005	322,497	189,684	58,459	570,640
Depreciation and amortization:				
2007	\$ 5,415	\$ 2,724	\$ 1,387	\$ 9,526
2006	5,059	2,173	1,432	8,664
2005	5,021	2,759	1,273	9,053
Capital expenditures:				
2007	\$ 7,060	\$ 2,399	\$ 2,191	\$ 11,650
2006	2,747	2,154	1,464	6,365
2005	2,872	2,846	2,386	8,104
Number of operating locations at year end:				
2007	139	32	—	171
2006	131	28	—	159
2005	133	29	—	162
Interest expense				
2007	\$ 535	\$ 119	\$ 17,690	\$ 18,344
2006	606	97	17,805	18,508
2005	734	107	17,746	18,587
Income tax expense (benefit) from continuing operations:				
2007	\$ 13,135	\$ 3,312	\$(11,379)	\$ 5,068
2006	10,501	1,307	(9,503)	2,305
2005	9,983	2,152	(12,667)	(532)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

23. SUPPLEMENTAL DISCLOSURE OF STATEMENT OF OPERATIONS INFORMATION

	<u>2005</u>	<u>For the year ended 2006</u>	<u>2007</u>
Revenues:			
Goods:			
Funeral	\$ 48,219	\$ 49,071	\$ 52,218
Cemetery	<u>26,772</u>	<u>24,384</u>	<u>29,153</u>
Total goods	\$ 74,991	\$ 73,455	\$ 81,371
Services:			
Funeral	\$ 62,664	\$ 65,117	\$ 72,590
Cemetery	<u>10,782</u>	<u>11,774</u>	<u>13,863</u>
Total services	\$ 73,446	\$ 76,891	\$ 86,453
Total revenues	<u>\$ 148,437</u>	<u>\$ 150,346</u>	<u>\$ 167,824</u>
Cost of revenues:			
Goods:			
Funeral	\$ 40,911	\$ 41,390	\$ 42,925
Cemetery	<u>18,657</u>	<u>19,302</u>	<u>20,490</u>
Total goods	\$ 59,568	\$ 60,692	\$ 63,415
Services:			
Funeral	\$ 31,520	\$ 31,930	\$ 34,766
Cemetery	<u>7,417</u>	<u>7,418</u>	<u>8,006</u>
Total services	\$ 38,937	\$ 39,348	\$ 42,772
Total cost of revenues	<u>\$ 98,505</u>	<u>\$ 100,040</u>	<u>\$ 106,187</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

24. QUARTERLY FINANCIAL DATA (UNAUDITED)

The tables below set forth consolidated operating results by fiscal quarter for the years ended December 31, 2006 and 2007, in thousands, except earnings per share.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2007				
Revenue from continuing operations	\$ 42,465	\$ 41,510	\$ 40,614	\$ 43,235
Gross profit from continuing operations	12,880	11,126	9,792	12,002
Income (loss) from continuing operations	\$ 2,992	\$ 1,916	\$ 731	\$ 1,886
Income (loss) from discontinued operations	431	40	(38)	321
Net income (loss)	<u>\$ 3,423</u>	<u>\$ 1,956</u>	<u>\$ 693</u>	<u>\$ 2,207</u>
Basic earnings per common share:				
Income (loss) from continuing operations	\$ 0.16	\$ 0.10	\$ 0.04	\$ 0.10
Loss from discontinued operations	0.02	—	—	0.02
Net income (loss) per basic share	<u>\$ 0.18</u>	<u>\$ 0.10</u>	<u>\$ 0.04</u>	<u>\$ 0.12</u>
Diluted earnings per common share (a):				
Income (loss) from continuing operations	\$ 0.16	\$ 0.10	\$ 0.04	\$ 0.10
Loss from discontinued operations	0.02	—	—	0.02
Net income (loss) per diluted share	<u>\$ 0.18</u>	<u>\$ 0.10</u>	<u>\$ 0.04</u>	<u>\$ 0.12</u>
2006				
Revenue from continuing operations	\$ 40,829	\$ 37,096	\$ 34,994	\$ 37,427
Gross profit from continuing operations	10,838	8,210	5,841	9,739
Income (loss) from continuing operations	\$ 2,224	\$ 609	\$ (500)	\$ 1,381
Income (loss) from discontinued operations	(3,959)	94	(65)	(1,200)
Net income (loss)	<u>\$ (1,735)</u>	<u>\$ 703</u>	<u>\$ (565)</u>	<u>\$ 181</u>
Basic earnings per common share (a):				
Income (loss) from continuing operations	\$ 0.12	\$ 0.04	\$ (0.03)	\$ 0.07
Loss from discontinued operations	(0.21)	—	—	(0.06)
Net income (loss) per basic share	<u>\$ (0.09)</u>	<u>\$ 0.04</u>	<u>\$ (0.03)</u>	<u>\$ 0.01</u>
Diluted earnings per common share (a):				
Income (loss) from continuing operations	\$ 0.12	\$ 0.04	\$ (0.03)	\$ 0.07
Loss from discontinued operations	(0.21)	—	—	(0.06)
Net income (loss) per diluted share	<u>\$ (0.09)</u>	<u>\$ 0.04</u>	<u>\$ (0.03)</u>	<u>\$ 0.01</u>

(a) Earnings per share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per share amounts does not equal the total computed for the year due to rounding and stock transactions which occurred during the periods presented.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

25. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

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

	Year Ended December 31,		
	2005	2006	2007
Cash paid for interest and financing costs	\$33,169	\$ 18,096	\$17,956
Cash paid (refunded) for income taxes	275	(312)	320
Stock issued to directors or officers	1,338	168	2,269
Loss on early extinguishment of debt	978	—	—
Net deposits in preneed funeral trusts	(5,138)	(5,731)	(1,109)
Net deposits in preneed cemetery trusts	(3,095)	(5,463)	(2,490)
Net deposits in perpetual care trusts	(1,155)	(5,227)	(1,035)
Net decrease in preneed funeral receivables	1,195	617	1,647
Net (increase) decrease in preneed cemetery receivables	(467)	1,311	(362)
Net withdrawals of receivables from preneed funeral trusts	663	604	4,106
Net change in preneed funeral receivables increasing (decreasing) deferred revenue	2,318	5,006	(511)
Net change in preneed cemetery receivables increasing (decreasing) deferred revenue	10,074	5,089	(5,123)
Net deposits (withdrawals) in preneed funeral trust accounts increasing (decreasing) non-controlling interests	1,304	(1,310)	1,291
Net deposits (withdrawals) in cemetery trust accounts increasing (decreasing) non-controlling interests	(379)	716	2,486
Deposits in perpetual care trust accounts increasing non-controlling interests	900	3,120	1,542
Restricted cash investing and financing activities:			
Proceeds from the sale of available for sale securities of the funeral and cemetery trusts	51,775	73,887	57,348
Purchase of available for sale securities of the funeral and cemetery trusts	61,223	62,323	83,064
Net deposits (withdrawals) in trust accounts increasing (decreasing) non-controlling interests	(2,123)	(11,789)	(8,760)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Carriage Services, Inc.:

We have audited and reported separately herein on the consolidated balance sheets of Carriage Services, Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2007.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements of Carriage Services, Inc. taken as a whole. The supplementary information included in Part IV, Item 15 (a)(2) is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Our report contains an explanatory paragraph that states the Company adopted the provisions of FASB Interpretation No. 48, effective January 1, 2007 and Statement of Financial Accounting Standards No. 123 (revised 2004), effective January 1, 2006.

/s/KPMG LLP

Houston, Texas
March 14, 2008

CARRIAGE SERVICES, INC.
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

Description	Beginning of year	Charged to Costs and Expenses	Deduction	Balance End of Year
Year ended December 31, 2005:				
Allowance for bad debts, current portion	\$ 940	\$2,024	\$2,027	\$ 937
Allowance for cemetery bad debts, contract cancellations and receivables from preneed funeral trusts, noncurrent portion	\$ 555	\$1,834	\$1,324	\$1,065
Environmental remediation reserves	\$ 103	\$ 110	\$ 70	\$ 143
Employee severance accruals	\$1,022	\$ 355	\$1,220	\$ 157
Office closing and other accruals	\$ 332	\$ 3	\$ 265	\$ 70
Year ended December 31, 2006:				
Allowance for bad debts, current portion	\$ 937	\$1,932	\$1,944	\$ 925
Allowance for cemetery bad debts, contract cancellations and receivables from preneed funeral trusts, noncurrent portion	\$1,065	\$3,020	\$2,882	\$1,203
Environmental remediation reserves	\$ 143	\$1,033	\$ 824	\$ 352
Employee severance accruals	\$ 157	\$ 451	\$ 482	\$ 126
Office closing and other accruals	\$ 70	\$ —	\$ 70	\$ —
Year ended December 31, 2007:				
Allowance for bad debts, current portion	\$ 925	\$1,002	\$ 785	\$1,142
Allowance for cemetery bad debts, contract cancellations and receivables from preneed funeral trusts, noncurrent portion	\$1,203	\$2,396	\$2,440	\$1,159
Environmental remediation reserves	\$ 352	\$ 92	\$ 444	\$ —
Employee severance accruals	\$ 126	\$ 63	\$ 189	\$ —

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Management's Evaluation of Disclosure Controls and Procedures

Our management, including our principal executive and financial officers, has evaluated the effectiveness of our disclosure controls and procedures to ensure that the information required to be disclosed in our filings under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and to ensure that such information is accumulated and communicated to management, including our principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive and financial officers have concluded that such disclosure controls and procedures were effective, as of December 31, 2007 (the end of the period covered by this Annual Report on Form 10-K).

Assessment of Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Management's report on our internal control over financial reporting is presented on page 33 of this Annual Report on Form 10-K. KPMG LLP, an independent registered public accounting firm, has issued an attestation report on our internal control over financial reporting. The report of KPMG LLP relating to the effectiveness of internal control over financial reporting, the Consolidated Financial Statements and the financial statement schedule are presented in this Annual Report on Form 10-K.

Changes in Internal Control Over Financial Reporting

Our management report on internal control over financial reporting for the year ended December 31, 2007 did not report any material weaknesses in our internal control over financial reporting or any changes in our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTIONS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 is incorporated by reference to the registrant's definitive proxy statement relating to its 2008 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), within 120 days after the end of the last fiscal year.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated by reference to the registrant's definitive proxy statement relating to its 2008 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 is incorporated by reference to the registrant's definitive proxy statement relating to its 2008 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is incorporated by reference to the registrant's definitive proxy statement relating to its 2008 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is incorporated by reference to the registrant's definitive proxy statement relating to its 2008 annual meeting of stockholders, which proxy statement will be filed pursuant to Regulation 14A of the Exchange Act within 120 days after the end of the last fiscal year.

PART IV**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES****(a) (1) FINANCIAL STATEMENTS**

The following financial statements and the Report of Independent Registered Public Accounting Firm are filed as a part of this report on the pages indicated:

	Page
Management's Report on Internal Control over Financial Reporting	33
Attestation of Independent Registered Public Accounting Firm	34
Report of Independent Registered Public Accounting Firm	35
Consolidated Balance Sheets as of December 31, 2006 and 2007	36
Consolidated Statements of Operations for the Years Ended December 31, 2005, 2006 and 2007	37
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2005, 2006 and 2007	38
Consolidated Statements of Cash Flows for the Years Ended December 31, 2005, 2006 and 2007	39
Notes to Consolidated Financial Statements	40

(2) FINANCIAL STATEMENT SCHEDULES

The following Financial Statement Schedule and the Report of Independent Registered Public Accounting Firm on Financial Statement Schedule are included in this report on the pages indicated:

	Page
Report of Independent Registered Public Accounting Firm on Financial Statement Schedule	69
Financial Statement Schedule II — Valuation and Qualifying Accounts	70

All other schedules are omitted as the required information is inapplicable or the information is presented in the Consolidated Financial Statements or related notes.

(3) EXHIBITS

The exhibits to this report have been included only with the copies of this report filed with the Securities and Exchange Commission. Copies of individual exhibits will be furnished to stockholders upon written request to Carriage Services, Inc. and payment of a reasonable fee.

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation, as amended, of the Company. Incorporated herein by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 1996.
3.2	Certificate of Amendment dated May 7, 1997. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended September 30, 1997.
3.3	Certificate of Amendment dated May 7, 2002. Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended June 30, 2002.
3.4	Certificate of Designation of the Company's Series G Junior Participating Preferred Stock. Incorporated by reference to Exhibit C to the Rights Agreement with American Stock Transfer & Trust Company dated December 18, 2000, which is attached as Exhibit 1 to the Company's Form 8-A filed December 29, 2000.
3.5	Amended and Restated Bylaws of the Company. Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (File No. 333-05545).
3.6	Amendments to the Bylaws of the Company effective December 18, 2000. Incorporated by reference to Exhibit 3.9 to the Company's Annual Report on Form 10-K for its year ended December 31, 2001.

[Table of Contents](#)

Exhibit No.	Description
4.1	Certificate of Trust of Carriage Services Capital Trust. Incorporated by reference to Exhibit 4.6 to the Company's Form S-3 Registration Statement No. 333-84141.
4.2	Amended and Restated Declaration of Trust of Carriage Services Capital Trust, dated June 3, 1999 among the Company, Wilmington Trust Company, Wilmington Trust Company, and Mark W. Duffey, Thomas C. Livengood and Terry E. Sanford. Incorporated by reference to Exhibit 4.7 to the Company's Form S-3 Registration Statement No. 333-84141.
4.3	Indenture for the Convertible Junior Subordinated Debentures due 2029 dated June 3, 1999 between the Company and Wilmington Trust Company. Incorporated by reference to Exhibit 4.8 to the Company's Form S-3 Registration Statement No. 333-84141.
4.4	Form of Carriage Services Capital Trust 7% Convertible Preferred Securities. Incorporated by reference to Exhibit 4.10 to the Company's Form S-3 Registration Statement No. 333-84141.
4.5	Form of the Company's Convertible Junior Subordinated Debentures due 2029. Incorporated by reference to Exhibit 4.11 to the Company's Form S-3 Registration Statement No. 333-84141.
4.6	Preferred Securities Guarantee dated June 3, 1999 between the Company and Wilmington Trust Company. Incorporated by reference to Exhibit 4.12 to the Company's Form S-3 Registration Statement No. 333-84141.
4.7	Common Securities Guarantee, dated June 3, 1999 by Carriage Services, Inc. as Guarantor. Incorporated by reference to Exhibit 4.13 to the Company's Form S-3 Registration Statement No. 333-84141.
4.8	Amendment No. 1 to Amended and Restated Declaration of Trust of Carriage Services Capital Trust. Incorporated by reference to Exhibit 4.14 to the Company's Form S-3 Registration Statement No. 333-84141.
4.9	Rights Agreement with American Stock Transfer & Trust Company dated December 18, 2000. Incorporated by reference to Exhibit 1 to the Company's Form 8-A filed December 29, 2000.
4.10	Indenture dated as of January 27, 2005 between Carriage Services, Inc., the Guarantors named therein, as Guarantors, and Wells Fargo Bank, National Association, as trustee. Incorporated herein by reference to Exhibit 4.1 to the Company's current report on Form 8-K dated January 27, 2005.
4.11	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. Incorporated by reference to Exhibit 4.5 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended June 30, 2005.
4.12	Amendment No. 1 to the Credit Agreement dated August 31, 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. Incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended September 30, 2005.
4.13	Amendment No. 2 to the Credit Agreement dated May 4, 2007 among Carriage Services, Inc., as the Borrower, Bank of America, N.A. as the Administrative Agent, Swing Line Lender and L/C Issuer and Wells Fargo Bank of Texas National Association, as Syndication Agent. Incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2007.
10.1	Amended and Restated 1996 Stock Option Plan. Incorporated herein by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 1996. †
10.2	Amendment No. 2 to 1996 Stock Option Plan. Incorporated by reference to Exhibit 10.2 to the Company's Form S-8 Registration Statement No. 333-85961. †
10.3	Second Amended and Restated 1996 Stock Incentive Plan. Incorporated by reference to Appendix C to the Company's 2005 Schedule 14A. †

[Table of Contents](#)

Exhibit No.	Description
10.4	Second Amended and Restated 1996 Director's Stock Option Plan. Incorporated by reference to Exhibit 99.1 to the Company's 2000 Schedule 14A. †
10.5	1998 Stock Option Plan for Consultants. Incorporated by reference to Exhibit 10.1 to the Company's Form S-8 Registration Statement No. 333-62593. †
10.6	Amendment No. 1 to the 1997 Employee Stock Purchase Plan. Incorporated by reference to Appendix B to the Company's 2005 Schedule 14A. †
10.7	Indemnity Agreement with Melvin C. Payne dated December 18, 2000. Incorporated by reference to Exhibit 10.20 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
10.8	Indemnity Agreement with Mark F. Wilson dated December 18, 2000. Incorporated by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
10.9	Indemnity Agreement with Ronald A. Erickson dated December 18, 2000. Incorporated by reference to Exhibit 10.27 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
10.10	Indemnity Agreement with Vincent D. Foster dated December 18, 2000. Incorporated by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
10.11	Indemnity Agreement with Joe R. Davis dated May 13, 2003. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2003. †
10.12	Indemnity Agreement with Joseph Saporito dated May 13, 2003. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2003. †
10.13	Indemnity Agreement with George J. Klug dated May 13, 2003. Incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2003. †
10.14	Termination Agreement with James J. Benard dated July 17, 2006. †
10.15	Employment Agreement with J. Bradley Green dated September 11, 2006. †
10.16	Contingent Asset Sale Agreement dated November 22, 2006 among Carriage Cemetery Services, Inc. and SCI Funeral Services, Inc.
10.17	Asset Purchase Agreement dated December 15, 2006 among Carriage Cemetery Services, Inc. and Seaside Cemetery, Inc.
10.18	Amendment No. 1 to the Contingent Asset Sale Agreement dated January 22, 2007 among Carriage Cemetery Services, Inc. and Alderwoods Group (California), Inc.
10.19	Amendment No. 2 to the Contingent Asset Sale Agreement dated February 26, 2007 among Carriage Cemetery Services, Inc. and Alderwoods Group (California), Inc.
10.20	Amendment No. 1 to the 2006 Long Term Incentive Plan. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2007. †
10.21	Employment agreement with Melvin C. Payne dated August 7, 2007. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated November 1, 2007. †
10.22	Employment agreement with Joseph Saporito dated August 24, 2007. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated November 1, 2007. †

Table of Contents

<u>Exhibit No.</u>	<u>Description</u>
10.23	Employment agreement with George J. Klug dated August 24, 2007. Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated November 1, 2007. †
10.24	Employment agreement with Terry E. Sanford dated August 24, 2007. Incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K dated November 1, 2007. †
10.25	Indemnity agreement with Gary Forbes dated August 7, 2007. Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for its quarter ended September 30, 2007. †
*10.26	Employment agreement with Kevin Musico dated August 7, 2007. †
10.27	Stock Purchase agreement as of June 12, 2007 among Carriage Cemetery Services of Idaho, Inc., buyer, and Timothy T. Gibson, seller, for 100 percent of the issued and outstanding capital stock of Cloverdale Park, Inc. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2007.
*10.28	Asset Purchase Agreement dated October 10, 2007 among Carriage Funeral Services of California, Inc. and Thaddeus M. Luyben, Sr. and Thaddeus Enterprises.
*12	Calculation of Ratio of Earnings to Fixed Charges.
14	Code of Business Conduct and Ethics. Carriage's Code of Business Conduct and Ethics is available on the website www.carriageservices.com .
18.1	Preferability letter from registered public accounting firm regarding change in accounting method dated August 1, 2005. Incorporated by reference to Exhibit 18.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2005.
*21.1	Subsidiaries of the Company.
*23.1	Consent of KPMG LLP.
*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	Certification of Periodic Financial Reports by Melvin C. Payne and Joseph Saporito in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002.

(*) Filed herewith.

(†) Management contract or compensatory plan or arrangement required to be filed as an exhibit hereto.

SIGNATURES

Pursuant to the requirements of section 13 or 15(d) of the securities exchange act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 14, 2008.

CARRIAGE SERVICES, INC.

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

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

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Melvin C. Payne</u> Melvin C. Payne	Chairman of the Board, Chief Executive Officer, President and Director (Principal Executive Officer)	March 14, 2008
<u>/s/ Joseph Saporito</u> Joseph Saporito	Executive Vice President, Chief Financial Officer and Secretary (Principal Financial Officer)	March 14, 2008
<u>/s/ Terry E. Sanford</u> Terry E. Sanford	Senior Vice President, Treasurer and Chief Accounting Officer (Principal Accounting Officer)	March 14, 2008
<u>/s/ Joe R. Davis</u> Joe R. Davis	Director	March 14, 2008
<u>/s/ Ronald A. Erickson</u> Ronald A. Erickson	Director	March 14, 2008
<u>/s/ Gary L. Forbes</u> Gary L. Forbes	Director	March 14, 2008
<u>/s/ Vincent D. Foster</u> Vincent D. Foster	Director	March 14, 2008

EXHIBIT INDEX

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation, as amended, of the Company. Incorporated herein by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 1996.
3.2	Certificate of Amendment dated May 7, 1997. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended September 30, 1997.
3.3	Certificate of Amendment dated May 7, 2002. Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended June 30, 2002.
3.4	Certificate of Designation of the Company's Series G Junior Participating Preferred Stock. Incorporated by reference to Exhibit C to the Rights Agreement with American Stock Transfer & Trust Company dated December 18, 2000, which is attached as Exhibit 1 to the Company's Form 8-A filed December 29, 2000.
3.5	Amended and Restated Bylaws of the Company. Incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (File No. 333-05545).
3.6	Amendments to the Bylaws of the Company effective December 18, 2000. Incorporated by reference to Exhibit 3.9 to the Company's Annual Report on Form 10-K for its year ended December 31, 2001.
4.1	Certificate of Trust of Carriage Services Capital Trust. Incorporated by reference to Exhibit 4.6 to the Company's Form S-3 Registration Statement No. 333-84141.
4.2	Amended and Restated Declaration of Trust of Carriage Services Capital Trust, dated June 3, 1999 among the Company, Wilmington Trust Company, Wilmington Trust Company, and Mark W. Duffey, Thomas C. Livengood and Terry E. Sanford. Incorporated by reference to Exhibit 4.7 to the Company's Form S-3 Registration Statement No. 333-84141.
4.3	Indenture for the Convertible Junior Subordinated Debentures due 2029 dated June 3, 1999 between the Company and Wilmington Trust Company. Incorporated by reference to Exhibit 4.8 to the Company's Form S-3 Registration Statement No. 333-84141.
4.4	Form of Carriage Services Capital Trust 7% Convertible Preferred Securities. Incorporated by reference to Exhibit 4.10 to the Company's Form S-3 Registration Statement No. 333-84141.
4.5	Form of the Company's Convertible Junior Subordinated Debentures due 2029. Incorporated by reference to Exhibit 4.11 to the Company's Form S-3 Registration Statement No. 333-84141.
4.6	Preferred Securities Guarantee dated June 3, 1999 between the Company and Wilmington Trust Company. Incorporated by reference to Exhibit 4.12 to the Company's Form S-3 Registration Statement No. 333-84141.
4.7	Common Securities Guarantee, dated June 3, 1999 by Carriage Services, Inc. as Guarantor. Incorporated by reference to Exhibit 4.13 to the Company's Form S-3 Registration Statement No. 333-84141.
4.8	Amendment No. 1 to Amended and Restated Declaration of Trust of Carriage Services Capital Trust. Incorporated by reference to Exhibit 4.14 to the Company's Form S-3 Registration Statement No. 333-84141.
4.10	Indenture dated as of January 27, 2005 between Carriage Services, Inc., the Guarantors named therein, as Guarantors, and Wells Fargo Bank, National Association, as trustee. Incorporated herein by reference to Exhibit 4.1 to the Company's current report on Form 8-K dated January 27, 2005.

Exhibit No.	Description
4.11	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. Incorporated by reference to Exhibit 4.5 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended June 30, 2005.
4.12	Amendment No. 1 to the Credit Agreement dated August 31, 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. Incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for its fiscal quarter ended September 30, 2005.
4.13	Amendment No. 2 to the Credit Agreement dated May 4, 2007 among Carriage Services, Inc., as the Borrower, Bank of America, N.A. as the Administrative Agent, Swing Line Lender and L/C Issuer and Wells Fargo Bank of Texas National Association, as Syndication Agent. Incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2007.
10.1	Amended and Restated 1996 Stock Option Plan. Incorporated herein by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 1996. †
10.2	Amendment No. 2 to 1996 Stock Option Plan. Incorporated by reference to Exhibit 10.2 to the Company's Form S-8 Registration Statement No. 333-85961. †
10.3	Second Amended and Restated 1996 Stock Incentive Plan. Incorporated by reference to Appendix C to the Company's 2005 Schedule 14A. †
10.4	Second Amended and Restated 1996 Director's Stock Option Plan. Incorporated by reference to Exhibit 99.1 to the Company's 2000 Schedule 14A. †
10.5	1998 Stock Option Plan for Consultants. Incorporated by reference to Exhibit 10.1 to the Company's Form S-8 Registration Statement No. 333-62593. †
10.6	Amendment No. 1 to the 1997 Employee Stock Purchase Plan. Incorporated by reference to Appendix B to the Company's 2005 Schedule 14A. †
10.7	Indemnity Agreement with Melvin C. Payne dated December 18, 2000. Incorporated by reference to Exhibit 10.20 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
10.8	Indemnity Agreement with Mark F. Wilson dated December 18, 2000. Incorporated by reference to Exhibit 10.24 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
10.9	Indemnity Agreement with Ronald A. Erickson dated December 18, 2000. Incorporated by reference to Exhibit 10.27 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
10.10	Indemnity Agreement with Vincent D. Foster dated December 18, 2000. Incorporated by reference to Exhibit 10.28 to the Company's Annual Report on Form 10-K for its fiscal year ended December 31, 2000. †
10.11	Indemnity Agreement with Joe R. Davis dated May 13, 2003. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2003. †
10.12	Indemnity Agreement with Joseph Saporito dated May 13, 2003. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2003. †
10.13	Indemnity Agreement with George J. Klug dated May 13, 2003. Incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2003. †
10.14	Termination Agreement with James J. Benard dated July 17, 2006. †

[Table of Contents](#)

Exhibit No.	Description
10.15	Employment Agreement with J. Bradley Green dated September 11, 2006. †
10.16	Contingent Asset Sale Agreement dated November 22, 2006 among Carriage Cemetery Services, Inc. and SCI Funeral Services, Inc.
10.17	Asset Purchase Agreement dated December 15, 2006 among Carriage Cemetery Services, Inc. and Seaside Cemetery, Inc.
10.18	Amendment No. 1 to the Contingent Asset Sale Agreement dated January 22, 2007 among Carriage Cemetery Services, Inc. and Alderwoods Group (California), Inc.
10.19	Amendment No. 2 to the Contingent Asset Sale Agreement dated February 26, 2007 among Carriage Cemetery Services, Inc. and Alderwoods Group (California), Inc.
10.20	Amendment No. 1 to the 2006 Long Term Incentive Plan. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2007. †
10.21	Employment agreement with Melvin C. Payne dated August 7, 2007. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated November 1, 2007. †
10.22	Employment agreement with Joseph Saporito dated August 24, 2007. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated November 1, 2007. †
10.23	Employment agreement with George J. Klug dated August 24, 2007. Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated November 1, 2007. †
10.24	Employment agreement with Terry E. Sanford dated August 24, 2007. Incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K dated November 1, 2007. †
10.25	Indemnity agreement with Gary Forbes dated August 7, 2007. Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for its quarter ended September 30, 2007. †
*10.26	Employment agreement with Kevin Musico dated August 7, 2007. †
10.27	Stock Purchase agreement as of June 12, 2007 among Carriage Cemetery Services of Idaho, Inc., buyer, and Timothy T. Gibson, seller, for 100 percent of the issued and outstanding capital stock of Cloverdale Park, Inc. Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2007.
*10.28	Asset Purchase Agreement dated October 10, 2007 among Carriage Funeral Services of California, Inc. and Thaddeus M. Luyben, Sr. and Thaddeus Enterprises.
*12	Calculation of Ratio of Earnings to Fixed Charges.
14	Code of Business Conduct and Ethics. Carriage's Code of Business Conduct and Ethics is available on the website www.carriageservices.com .
18.1	Preferability letter from registered public accounting firm regarding change in accounting method dated August 1, 2005. Incorporated by reference to Exhibit 18.1 to the Company's Quarterly Report on Form 10-Q for its quarter ended June 30, 2005.
*21.1	Subsidiaries of the Company.
*23.1	Consent of KPMG LLP.
*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	Certification of Periodic Financial Reports by Melvin C. Payne and Joseph Saporito in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002.

(*) Filed herewith.

(†) Management contract or compensatory plan or arrangement required to be filed as an exhibit hereto.

EMPLOYMENT AGREEMENT

THIS AGREEMENT, dated August 7, 2007, is between CARRIAGE SERVICES, INC., a Delaware corporation (the "Company"), and Kevin P. Musico, a resident of Harris County, Texas (the "Employee").

1. Employment Term. The Company hereby continues the employment of the Employee for a term commencing as of the date first above written and, subject to earlier termination or extension as provided in Section 7 hereof, continuing until August 6, 2010 (such term being herein referred to as the "term of this Agreement"). The term of this Agreement shall automatically be renewed on an annual basis thereafter, unless terminated by either party upon sixty (60) days' written notice prior to the end of the term then in effect. The Employee agrees to accept such employment and to perform the services specified herein, all upon the terms and conditions hereinafter stated.

2. Duties. The Employee shall serve the Company and shall report to, and be subject to the general direction and control of the Chief Executive Officer of the Company. The Employee shall faithfully, diligently, competently, and to the best of Employee's ability, perform the management and administrative duties of Vice President of Corporate Development. The Employee shall also serve as Vice President of Corporate Development of any subsidiary of the Company as requested by the Company, and the Employee shall perform such other duties as are from time to time assigned to him by the Chief Executive Officer as are not inconsistent with the provisions hereof. The Employee represents and warrants to the Company that Employee is not subject to any obligation to any third party that would restrict or interfere with Employee's ability to perform hereunder.

3. Extent of Service. The Employee shall devote his full business time and attention to the business of the Company, and, except as may be specifically permitted by the Company, shall not be engaged in any other business activity during the term of this Agreement. The foregoing shall not be construed as preventing the Employee (i) from making passive investments in other businesses or enterprises, and (ii) from engaging in other civic, charitable and business activities, provided, however, that such investments and activities will not require services on the part of the Employee which would in any way impair the performance of his duties under this Agreement.

4. Compensation. During the term of this Agreement, the Company shall pay the Employee an annual salary of not less than \$210,000.00 per full calendar year of service completed ("Base Salary"), appropriately prorated for partial months at the commencement and end of the term of this Agreement. The Employee's salary and benefits will be reviewed annually, and any increase therein shall remain in the sole discretion of the Company, acting through the Compensation Committee of its Board of Directors if required. The salary set forth herein shall not be subject to reduction and shall be payable in bi-weekly installments in accordance with the payroll policies of the Company in effect from time to time during the term of this Agreement. The Company shall have the right to deduct from any payment of all compensation to the Employee hereunder (x) any federal, state or local taxes required by law to

be withheld with respect to such payments, and (y) any other amounts specifically authorized to be withheld or deducted by the Employee.

5. Benefits. In addition to the Base Salary, the Employee shall be entitled to participate in the following benefits during the term of this Agreement:

(i) Consideration for an annual performance-based bonus within the sole discretion of the Company, as may be recommended by the Chief Executive Officer and approved by the Compensation Committee of the Company's Board of Directors. A target bonus will be set by the Company, and approved by the Compensation Committee of the Company's Board of Directors, on an annual basis.

(ii) An Award of 20,000 shares of the Company's Restricted Stock as of the Effective Date of this Agreement, within the meaning of and subject to the terms and conditions of the Company's 2006 Long Term Incentive Plan and the related Award Agreement to be entered into between the Company and the Employee evidencing such Award; provided that such Award shall vest at the rate of 25% per year on June 20 in each year, commencing June 20, 2008.

(iii) Eligibility for consideration of future Awards of Restricted Stock or other incentive-based compensation under the terms of the Company's 2006 Long Term Incentive Plan or one or more of the Company's other incentive plans, as the Chief Executive Officer in his sole discretion may determine and subject to approval of the Company's Compensation Committee.

(iv) Four weeks of paid vacation in each calendar year, subject to the Company's personnel policies respecting such matters.

(v) Participation in the Company's group health and hospitalization program, and inclusion in such other employee benefits, as are available generally to executive-level employees of the Company.

(vi) Reimbursement for travel, lodging and other out-of-pocket expenses reasonably incurred by Employee in the exercise of Employee's duties under this Agreement which are approved by the Company in advance and are duly substantiated in accordance with the Company's policies as to reimbursement. In order to assure compliance with Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), such reimbursements shall be made as soon as practicable, but in no event later than the last day of the calendar year following the calendar year in which the expense was incurred.

6. Certain Additional Matters. The Employee agrees that at all times during the term of this Agreement and for a period of two years following any cessation of employment with the Company:

(a) The Employee will not knowingly or intentionally do or say any act or thing which will or may impair, damage or destroy the goodwill and esteem for the Company held by its suppliers, employees, patrons, customers and others who may at any time have or have had business relations with the Company.

(b) The Employee will not knowingly or intentionally do any act or thing detrimental to the Company or its business.

Nothing herein shall be construed to prevent the Employee from complying with any requirements of law or legal process or taking such actions as the Company may consent to in writing.

7. Termination.

(a) Death. If the Employee dies during the term of this Agreement and while in the employ of the Company, this Agreement shall automatically terminate and the Company shall have no further obligation to the Employee or his estate except that the Company shall pay the Employee's estate (i) that portion of the Employee's Base Salary accrued through the date on which the Employee's death occurred, (ii) a pro rata amount of the annual bonus described in Section 5(i) above, based on the number of days the Employee was employed in the year in comparison to 365, and (iii) all benefits payable under the governing provisions of any benefit plan or program of the Company. Such payment of Base Salary and bonus to the Employee's estate shall be made in the same manner and at the same times as they would have been paid to the Employee had he not died.

(b) Disability. If during the term of this Agreement, the Employee shall be prevented from performing his duties hereunder by reason of disability, and such disability shall continue for a period of six months, then the Company may terminate this Agreement at any time after the expiration of such six-month period. For purposes of this Agreement, the Employee shall be deemed to have become disabled when the Company, upon the advice of a qualified physician, shall have determined that the Employee is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months. In the event of a termination pursuant to this paragraph (b), the Company shall be relieved of all its obligations under this Agreement, except that the Company shall pay to the Employee (or his estate in the event of his subsequent death), (i) the Employee's Base Salary through the date on which such termination shall have occurred, reduced during such period by the amount of any benefits received under any disability policy maintained by the Company, (ii) a pro rata amount of the annual bonus described in Section 5(i) above, based on the number of days the Employee was employed in the year in comparison to 365, and (iii) all benefits payable under the governing provisions of any benefit plan or program of the Company. All such payments to the Employee or his estate shall be made in the same manner and at the same times as they would have been paid to the Employee

had he not become disabled. No such termination pursuant to this paragraph (b) will relieve the Employee of his obligations under Sections 6, 8 and 9 hereunder.

(c) Discharge for Cause. Prior to the end of the term of this Agreement, the Company may discharge the Employee for Cause and terminate this Agreement. In such case this Agreement shall automatically terminate and the Company shall have no further obligation to the Employee or his estate other than to pay to the Employee (or his estate in the event of his subsequent death) that portion of the Employee's salary accrued through the date of termination.

For purposes of this Agreement, the Company shall have "Cause" to discharge the Employee or terminate the Employee's employment hereunder upon (i) the Employee's conviction of any felony or any other crime involving moral turpitude, (ii) the Employee's repeated failure or refusal to perform all of his duties, obligations and agreements herein contained or imposed by law, including his fiduciary duties, to the reasonable satisfaction of the Company's Board of Directors, (iii) the Employee's commission of acts amounting to gross negligence or willful misconduct to the detriment of the Company, or (iv) the Employee's material breach of any provision of this Agreement or uniformly applied provisions of the Company's employee handbook or other personnel policies, including without limitation, its Code of Business Conduct and Ethics. Such determination of "Cause" shall be made by the Company's Board of Directors, and in the event of circumstances described in (ii) or (iv), the Board shall give written notice to the Employee specifying such circumstances and providing a period of 30 days in which the Employee shall be allowed to cure such circumstances.

Any such termination by virtue of this paragraph (c) shall not prejudice any remedy that the Company may have at law, in equity, or under this Agreement, for breach hereof by Employee. No such termination pursuant to this paragraph (c) will relieve the Employee of his obligations under Sections 6, 8 and 9 hereunder.

(d) Discharge Without Cause. Prior to the end of the term of this Agreement, the Company may discharge the Employee without Cause (as defined in paragraph (c) above) and terminate this Agreement. In such case this Agreement shall automatically terminate and the Company shall have no further obligation to the Employee or his estate, except that the Company shall continue to pay to the Employee (or his estate in the event of his subsequent death), (i) the Employee's Base Salary for a period of 18 months following the date of discharge, (ii) 50% of the annual target bonus described in Section 5(i) above for the year of termination, and (iii) all benefits payable under the governing provisions of any benefit plan or program of the Company. In addition, if following the date of such discharge, the Employee becomes eligible to elect continuation coverage under the Consolidated Omnibus Budget Reconciliation Act ("COBRA") and properly elects such coverage, the Company shall reimburse the Employee or pay on the Employee's behalf 100% of applicable medical continuation premiums for the benefit of the Employee (and his covered dependents as of the date of his termination, if any) under the Employee's then-current plan election, with such coverage to be provided under the closest comparable plan as offered by the Company from time to time, for so long during

the 18-month period following termination as he remains eligible for and elects COBRA coverage, except as otherwise provided in paragraph (e) below. All such payments to the Employee or his estate shall be made in the same manner and at the same times as they would have been paid to the Employee had he not been discharged. No such termination pursuant to this paragraph (d) will relieve the Employee of his obligations under Sections 6, 8 and 9 hereunder.

(e) Corporate Change. If following a Corporate Change (as defined in the Company's 2006 Long-Term Incentive Plan), the Employee voluntarily terminates his employment for Good Reason (as defined below) or the Employee is discharged without Cause, in either case within 24 months following the Corporate Change, then this Agreement shall automatically terminate and the Company shall have no further obligation to the Employee or his estate, except that the Company shall pay to the Employee (or his estate in the event of his subsequent death), (i) a lump sum payment payable following such termination equal to one and one-half times the Employee's Base Salary, (ii) 50% of the annual target bonus described in Section 5(i) above for the year of termination and (iii) all benefits payable under the governing provisions of any benefit plan or program of the Company. In addition, if following the date of such resignation or discharge, the Employee becomes eligible to elect continuation coverage under COBRA and properly elects such coverage, the Company shall reimburse the Employee or pay on the Employee's behalf 100% of applicable medical continuation premiums for the benefit of the Employee (and his covered dependents as of the date of his termination, if any) under the Employee's then-current plan election, with such coverage to be provided under the closest comparable plan as offered by the Company from time to time, for so long during the 18-month period following the date of resignation or discharge as he remains eligible for and elects COBRA coverage. No such termination pursuant to this paragraph (e) will relieve the Employee of his obligations under Sections 6 and 9 hereunder.

"Good Reason" means any of the following actions if taken without the Employee's prior written consent: (A) any material breach by the Company to comply with its obligations under the terms of the Agreement; (B) any material diminution in the Employee's responsibilities, authority or duties, (C) a material diminution in the Employee's Base Salary; or (D) any material change in the permanent location at which the Employee performs services for the Company. The Employee shall give written notice to the Board specifying such actions within 90 days of the existence of such action and providing a period of 30 days in which the Company shall be allowed to cure such circumstances

8. Restrictive Covenants. The Company has provided and shall provide in the future to the Employee, confidential and proprietary information as that term is defined in Section 9 of this Agreement ("Confidential Information"). The Employee acknowledges that in the course of his employment with the Company as a member of the Company's senior executive and management team, he shall be given possession of and access to Confidential Information of the Company and its affiliates, and will develop through such employment business systems, methods of doing business, and contacts within the death care industry, all of which will help to

identify him with the business and goodwill of the Company. Consequently, it is important that the Company protect its interests in regard to such matters from unfair competition. In consideration of the Confidential Information that has been received and that the Company covenants to provide the Employee in the future, the sufficiency of which is hereby acknowledged by the Employee, the Employee agrees to enter into the covenants contained in this Agreement. The parties therefore agree that for so long as the Employee shall remain employed by the Company and, if the employment of the Employee ceases for any reason (including voluntary resignation), then for a period of two (2) years thereafter, the Employee shall not, directly or indirectly:

(i) alone or for his own account, or as a officer, director, shareholder, partner, member, trustee, employee, consultant, advisor, agent or any other capacity of any corporation, partnership, joint venture, trust, or other business organization or entity, encourage, support, finance, be engaged in, interested in, or concerned with (x) any of the companies and entities described on Schedule I hereto, except to the extent that any activities in connection therewith are confined exclusively outside the continental United States, or (y) any other business within the death care industry having an office or being conducted within a radius of fifty (50) miles of any funeral home, cemetery or other death care business owned or operated by the Company or any of its subsidiaries at the time of such termination;

(ii) induce or assist anyone in inducing in any way any employee of the Company or any of its subsidiaries to resign or sever his or her employment or to breach an employment contract with the Company or any such subsidiary; or

(iii) own, manage, advise, encourage, support, finance, operate, join, control, or participate in the ownership, management, operation, or control of or be connected in any manner with any business which is or may be in the funeral, mortuary, crematory, cemetery or burial insurance business or in any business related thereto (x) as part of any of the companies or entities listed on Schedule I, or (y) otherwise within a radius of fifty (50) miles of any funeral home, cemetery or other death care business owned or operated by the Company or any of its subsidiaries at the time of such termination.

Notwithstanding the foregoing, the above covenants shall not prohibit the passive ownership of not more than one percent (1%) of the outstanding voting securities of any entity within the death care industry. The foregoing covenants shall not be held invalid or unenforceable because of the scope of the territory or actions subject hereto or restricted hereby, or the period of time within which such covenants respectively are operative, but the maximum territory, the action subject to such covenants and the period of time they are enforceable are subject to any determination by a final judgment of any court which has jurisdiction over the parties and subject matter.

9. Confidential Information; Copyrightable Material. The Employee acknowledges that in the course of his employment by the Company he shall receive and access certain trade secrets, management methods, financial and accounting data (including, but not limited to, reports, studies, analyses, spreadsheets and other materials and information), operating

techniques, prospective acquisitions, employee lists, training manuals and procedures, personnel evaluation procedures, and other confidential information and knowledge concerning the business of the Company and its affiliates (hereinafter collectively referred to as "Confidential Information") which the Company desires to protect. The Employee understands that the Confidential Information is confidential and he agrees not to reveal the Confidential Information to anyone outside the Company so long as the confidential or secret nature of the Confidential Information shall continue, except as required by law or legal process. The Employee further agrees that he will at no time use the Confidential Information in competing with the Company. Upon termination of this Agreement, the Employee shall surrender to the Company all papers, documents, writings and other property produced by him or coming into his possession by or through his employment or relating to the Confidential Information and the Employee agrees that all such materials will at all times remain the property of the Company. The Employee acknowledges that all materials and other copyrightable works and subject matter (regardless of whether or not constituting "Confidential Information") produced by the Employee within the scope of his employment (regardless of whether or not denoted as copyrighted material) shall be deemed "works made for hire" and shall be owned by and proprietary to the Company and may not be used or reproduced in whole or in part without the Company's prior written consent.

10. Remedies. The parties recognize that the services to be rendered under this Agreement by the Employee are special, unique, and of extraordinary character, and that in the event of the breach by the Employee of the covenants contained in Section 8 or Section 9 hereof, the Company may suffer irreparable harm as a result. The parties therefore agree that, in the event of any breach or threatened breach of any of such covenants, the Company shall be entitled to specific performance or injunctive relief, or both, and may, in addition to and not in lieu of any claim or proceeding for damages, institute and prosecute proceedings in any court of competent jurisdiction to enforce through injunctive relief such covenants. In addition, the Company may, if it so elects, suspend (if applicable) any payments due under this Agreement pending any such breach and offset against any future payments the amount of the Company's damages arising from any such breach. The Employee agrees to waive and hereby waives any requirement for the Company to secure any bond in connection with the obtaining of such injunction or other equitable relief.

11. Notices. All notices, requests, consents and other communications under this Agreement shall be in writing and shall be deemed to have been delivered on the date personally delivered or three business days after the date mailed, postage prepaid, by certified mail, return receipt requested, or when sent by electronic means or facsimile and receipt is confirmed, if addressed to the respective parties as follows:

If to the Employee: Kevin P. Musico
2 Julian Woods Place
The Woodlands, Texas 77382

If to the Company: Carriage Services, Inc.
3040 Post Oak Blvd, Suite 300
Houston, Texas 77056
Attn: Chief Executive Officer

Either party hereto may designate a different address by providing written notice of such new address to the other party hereto.

12. Severability. Whenever possible, each provision of this Agreement shall be interpreted in such manner as to be effective and valid under applicable law but if any provision of this Agreement shall be prohibited by or invalid under applicable law, such provision shall be ineffective to the extent of such provision or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement.

13. Assignment. This Agreement may not be assigned by the Employee. Neither the Employee nor his estate shall have any right to commute, encumber or dispose of any right to receive payments hereunder, it being agreed that such payments and the right thereto are nonassignable and nontransferable.

14. Binding Effect. Subject to the provisions of Section 13 of this Agreement, this Agreement shall be binding upon and inure to the benefit of the parties hereto, the Employee's heirs and personal representatives, and the successors and assigns of the Company.

15. Captions. The section and paragraph headings in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

16. Complete Agreement. This Agreement represents the entire agreement between the parties concerning the subject hereof and supersedes all prior agreements and arrangements between the parties concerning the subject thereof.

17. Governing Law; Venue. A substantial portion of the Employee's duties under this Agreement shall be performed at the Company's corporate headquarters in Houston, Texas, and this Agreement has been substantially negotiated and is being executed and delivered in the State of Texas. This Agreement shall be construed and enforced in accordance with and governed by the laws of the State of Texas. Any suit, claim or proceeding arising under or in connection with this Agreement or the employment relationship evidenced hereby must be brought, if at all, in a state district court in Harris County, Texas or federal district court in the Southern District of Texas, Houston Division. Each party submits to the jurisdiction of such courts and agrees not to raise any objection to such jurisdiction.

18. Survival. The provisions of Sections 6, 8 and 9 shall survive any termination of this Agreement or the employment relationship of the Company and Employee; provided,

however, if such termination is the result of Corporate Change as provided in Section 7(e) hereof, Employee shall not thereafter be bound by the provisions of Section 8 hereof.

19. Counterparts. This Agreement may be executed in multiple original counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

20. Time of Payments. All amounts payable under Sections 7(d) and (e) of this Agreement shall be paid within 10 days after the Employee's execution without revocation of a release in a form satisfactory to the Company and within the time period prescribed by the Company (which may not be less than 21 days after the date of termination of employment). If the Employee is a "specified employee," as such term is defined in Section 409A of the Code and related regulations and Treasury pronouncements ("Section 409A") and determined as described below in this Section 20, any payments payable as a result of the Employee's termination (other than death) shall not be payable before the earliest of (i) the date that is six months after the Employee's termination, (ii) the date of the Employee's death, or (iii) the date that otherwise complies with the requirements of Section 409A. This Section 20 shall be applied by accumulating all payments that otherwise would have been paid within six months of the Employee's termination and paying such accumulated amounts at the earliest date which complies with the requirements of Section 409A. The Employee shall be a "specified employee" for the twelve-month period beginning on April 1 of a year if the Employee is a "key employee" as defined in Section 416(i) of the Code (without regard to Section 416(i)(5)) as of December 31 of the preceding year or using such dates as designated by the Company in accordance with Section 409A and in a manner that is consistent with respect to all of the Company's nonqualified deferred compensation plans. For purposes of determining the identity of specified employees, the Company may establish procedures as it deems appropriate in accordance with Section 409A.

21. Income, Excise or Other Tax Liability. The Company may withhold from any benefits and payments made pursuant to this Agreement all federal, state, city and other taxes as may be required pursuant to any law or governmental regulation or ruling and all other normal employee deductions made with respect to the Company's employees generally. Notwithstanding anything in this Agreement to the contrary, in the event it shall be determined that any payment or distribution by the Company to the Employee or for his benefit, whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise (a "Payment"), would be subject to the excise tax imposed by Section 4999 of the Code, or any interest or penalties with respect to such excise tax (such excise tax, together with any such interest or penalties, are hereinafter collectively referred to as the "Excise Tax"), the Company shall pay to the Employee an additional payment (a "Gross-up Payment") in an amount such that after payment by the Employee of all taxes (including any interest or penalties imposed with respect to such taxes), including any Excise Tax imposed on any Gross-up Payment, the Employee retains an amount of the Gross-up Payment equal to the Excise Tax imposed upon the Payments. All determinations required to be made under this Section 21 shall be made by the Company's accounting firm (the "Accounting Firm"). The Accounting Firm shall provide detailed supporting calculations both to the Company and the Employee. All fees and expenses of the Accounting Firm shall be borne solely by the Company. Absent manifest

error, any determination by the Accounting Firm shall be binding upon the Company and the Employee.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date and year first above written.

CARRIAGE SERVICES, INC.

By: /s/ Melvin C. Payne
MELVIN C. PAYNE, Chief Executive Officer

/s/ Kevin P. Musico
Kevin P. Musico

SCHEDULE I
TO
EMPLOYMENT AGREEMENT

1. The following entities, together with all Affiliates thereof:

Service Corporation International
Alderwoods Group, Inc.
Stewart Enterprises, Inc.
Keystone North America, Inc.
Meridian Mortuary Group, Inc.
StoneMor Partners LP
Saber Management LLC
Thomas Pierce & Co.
Legacy Funeral Holdings, LLC
Northstar Memorial Group, LLC

For purposes of the foregoing, an “Affiliate” of an entity is a person that directly or indirectly controls, is under the control of or is under common control with such entity.

2. Any new entity which may hereafter be established which acquires any combination of ten or more funeral homes and/or cemeteries from any of the entities described in 1 above.
3. Any funeral home, cemetery or other death care enterprise which is managed by any entity described in 1 or 2 above.

EXECUTION COPY

ASSET PURCHASE AGREEMENT
BY
CARRIAGE FUNERAL SERVICES OF CALIFORNIA, INC.,
AS BUYER,
THADDEUS M. LUYBEN, SR.
AS SELLER,
AND
THADDEUS ENTERPRISES
Dated
October 10, 2007

TABLE OF CONTENTS

ARTICLE I. DEFINITIONS AND INTERPRETATION	2
1.1 Definitions	2
1.2 Interpretation	8
ARTICLE II. PURCHASE AND SALE OF ASSETS	9
2.1 Transfer of Assets by Seller and the Company	9
2.2 Retained Assets	10
2.3 Assumption of Liabilities	11
2.4 Limitations on Assumption	11
ARTICLE III. CONSIDERATION AND CLOSING	12
3.1 Purchase Price	12
3.2 Certain Prorations	13
3.3 Taxes; Closing Costs	13
3.4 The Closing	13
3.5 Closing Deliveries	14
ARTICLE IV. REPRESENTATIONS AND WARRANTIES OF SELLER AND THE COMPANY	16
4.1 Incorporation and Power	16
4.2 Valid and Binding Agreement	16
4.3 No Conflicts and Consents	17
4.4 Financial Statements	17
4.5 Books and Records	18
4.6 Absence of Certain Developments	18
4.7 Inventory; Accounts Receivable	19
4.8 Tax Matters	19
4.9 Intellectual Property	20
4.10 Contracts	20
4.11 Preneed Contracts and Trust Accounts.	21
4.12 Litigation	22
4.13 Insurance and Claims	23
4.14 Governmental Authorizations	23
4.15 Compliance with Laws	23
4.16 Environmental Matters	23
4.17 Employees	24

4.18 Employee Benefit Plans	24
4.19 Title to and Status of Purchased Assets	24
4.20 Real Property	25
4.21 Tangible Personal Property	25
4.22 Availability of Documents	25
4.23 Finders	25
4.24 Full Disclosure	26
ARTICLE V. REPRESENTATIONS AND WARRANTIES OF BUYER	26
5.1 Incorporation; Power and Authority	26
5.2 Valid and Binding Agreement	26
5.3 No Conflict and Consents	26
5.4 Finders	26
5.5 Full Disclosure	27
ARTICLE VI. COVENANTS OF SELLER, THE COMPANY AND BUYER	27
6.1 Conduct of the Business	27
6.2 Notice of Developments	28
6.3 Access to Information	28
6.4 No Shop	29
6.5 Employee Training; Systems Installation	29
6.6 Non-Competition	29
6.7 Employee Matters	31
6.8 Further Assurances	31
6.9 Post-Closing Access	31
6.10 Buyer's Trustee and Preneed Trust Funds	32
6.11 Unique Preneed Merchandise	32
6.12 Litigation	32
ARTICLE VII. OTHER COVENANTS	32
7.1 Efforts	32
7.2 Further Assurances	33
ARTICLE VIII. CONDITIONS TO CLOSING	34
8.1 Conditions to Obligation of Each Party to Close	34
8.2 Conditions to Buyer's Obligation to Close	34
8.3 Conditions to the Company's or Seller's Obligation to Close	36
ARTICLE IX. TERMINATION	37

9.1 Termination	37
9.2 Effect of Termination	38
ARTICLE X. INDEMNIFICATION	38
10.1 Indemnification by the Company and Seller	38
10.2 Indemnification by Buyer	39
10.3 Procedures for Indemnification	40
ARTICLE XI. GENERAL	41
11.1 Press Releases and Announcements	41
11.2 Expenses	41
11.3 Amendment and Waiver	41
11.4 Notices	42
11.5 Assignment	43
11.6 No Third Party Beneficiaries	43
11.7 Severability	43
11.8 Complete Agreement	44
11.9 Schedules	44
11.10 Signatures; Counterparts	44
11.11 GOVERNING LAW	44
11.12 Specific Performance	44
11.13 Dispute Resolution	44
11.14 Construction	45
EXHIBITS	
EXHIBIT A	Grant Deed
EXHIBIT B	Justin Employment Agreement
EXHIBIT C	Justin Non-Competition Agreement
EXHIBIT D	Luyben Jr. Employment Agreement
EXHIBIT E	Luyben Jr. Non-Competition Agreement
EXHIBIT F	Luyben Sr. Consulting Agreement
EXHIBIT 3.5(a)(xii)	Opinion of Seller Counsel
EXHIBIT 3.5(a)(xvi)	Right of First Refusal Agreement
EXHIBIT 3.5(b)(vi)	Opinion of Buyer Counsel
EXHIBIT G	Substitution of Trustor Agreement
SELLER DISCLOSURE SCHEDULE	
SECTION 4.4	Disposition Contracts
SECTION 4.6	Certain Developments

SECTION 4.9	Intellectual Property
SECTION 4.10	Contracts
SECTION 4.11	Preneed Contracts & Trust Accounts
SECTION 4.14	Governmental Authorizations
SECTION 4.16	Environmental Matters
SECTION 4.17	Employees
SECTION 4.18	Employee Benefit Plans
SECTION 4.20	Real Property
SECTION 4.21	Tangible Personal Property

ASSET PURCHASE AGREEMENT

This **ASSET PURCHASE AGREEMENT** (this “*Agreement*”) is made as of October 10, 2007, by **Carriage Funeral Services of California, Inc.**, a California corporation (“*Buyer*”), **Thaddeus M. Luyben, Sr.**, an individual (“*Seller*”), and **Thaddeus Enterprises** (d/b/a Evans Brown Mortuary and Hemet Valley Mortuary), a California corporation (the “*Company*”). Buyer, Seller and the Company shall each be referred to herein as a “*Party*” and collectively as the “*Parties*.”

Recitals

WHEREAS, through the Company, Seller owns and operates (i) a funeral business, a cremation business (together, the “*Sun City Business*”) and funeral home located at 27010 Encanto Drive, Sun City, Riverside County, California (the “*Sun City Home*”); (ii) a funeral business, cremation business (together, the “*Perris Business*”), funeral home and funeral home real estate located at 385 West 4th Street, Perris, Riverside County, California (the “*Perris Home*”); (iii) a funeral business, cremation business (together, the “*Lake Elsinore Business*”), funeral home and funeral home real estate located at 126 East Graham Avenue, Lake Elsinore, Riverside County, California (the “*Lake Elsinore Home*”); and (iv) a funeral business, cremation business (together, the “*Hemet Business*” and together with the Sun City Business, the Perris Business and the Lake Elsinore Business, collectively, the “*Businesses*”), funeral home and funeral home real estate (d/b/a Hemet Valley Mortuary) located at 403 North San Jacinto Street, Hemet, Riverside County, California (the “*Hemet Home*” and, together with the Sun City Home, the Perris Home and the Lake Elsinore Home, collectively, the “*Facilities*”);

WHEREAS, as of the date of this Agreement the Seller owns the funeral home real estate and improvements of the Perris Home, the Lake Elsinore Home and the Hemet Home;

WHEREAS, Seller owns a valid leasehold interest in the Sun City Lease, and the Company owns the improvements located at the Sun City Home; and

WHEREAS, the Parties desire that (i) Buyer acquire substantially all of the assets, rights, and properties of the Businesses and the Facilities, including the real estate of each of the Perris Home, the Lake Elsinore Home, and the Hemet Home, from both Seller and the Company; (ii) Buyer acquire the improvements located at the Sun City Home from Company; (iii) Seller cause the Sun City Lease (as hereinafter defined) to be terminated; and (iv) Seller facilitate the execution of the New Sun City Ground Lease (as hereinafter defined) with New Lessor (as hereinafter defined) and that the Parties enter into certain related transactions on the terms and subject to the conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual representations, warranties and agreements contained in this Agreement, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

ARTICLE I.
DEFINITIONS AND INTERPRETATION

1.1 Definitions. In this Agreement, the following capitalized terms shall have the meanings set forth below:

“AAA” has the meaning set forth in Section 11.13(a).

“*Adverse Consequences*” means all suits, proceedings, hearings, investigations, charges, complaints, Claims, injunctions, judgments, orders, decrees, rulings, damages, dues, penalties, fines, costs, amounts paid in settlement, Liabilities, taxes, Encumbrances, Losses, expenses, and fees, including court costs and reasonable attorneys’ fees and expenses.

“*Affiliate*” means, with respect to any specified Person, any other Person who or which, directly or indirectly, controls, is controlled by, or is under common control with such specified Person, including any partner, officer, director, member or employee of such Person. For purposes of this definition, “control” (including, with correlative meanings, “controlling”, “controlled by”, and “under common control with”) means the power to direct or cause the direction of the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise.

“*Agreement*” has the meaning set forth in the first paragraph of this Agreement.

“*Ancillary Agreements*” means the General Bill of Sale, the General Assignment and Assumption Agreement, the Deeds and the Transaction Documents.

“*Annual Financial Statements*” has the meaning set forth in Section 4.4(a).

“*Assigned Contracts*” has the meaning set forth in Section 7.1(b).

“*Assumed Liabilities*” has the meaning set forth in Section 2.3.

“*Businesses*” has the meaning set forth in the recitals of this Agreement.

“*Business Day*” means a day (excluding Saturday and Sunday) on which banks generally are open for the transaction of business in the State of California.

“*Buyer*” has the meaning set forth in the first paragraph of this Agreement.

“*Buyer Indemnified Party*” has the meaning set forth in Section 10.1(a).

“*Buyer’s Trustee*” has the meaning set forth in Section 6.10.

“*CERCLA*” means the Comprehensive Environmental Compensation and Liability Act of 1980, as amended.

“*Claim*” means any demand, claim, action, investigation, legal proceeding or arbitration, whether or not ultimately determined to be valid.

“*Claim Notice*” has the meaning set forth in Section 10.3(a).

“*Closing*” has the meaning set forth in Section 3.4(a).

“*Closing Date*” has the meaning set forth in Section 3.4(a).

“*Code*” means the Internal Revenue Code of 1986, as amended.

“*Consent*” means any authorization, consent, approval, filing, waiver, exemption or other action by or notice to any Person.

“*Contract*” means a contract, agreement, commitment or binding understanding, whether oral or written, that is in effect as of the date of this Agreement or any time after the date of this Agreement.

“*Deeds*” has the meaning set forth in Section 3.5(a)(iv).

“*Direct Claim*” has the meaning set forth in Section 10.3(a).

“*Dispute*” has the meaning set forth in Section 11.13(a).

“*Encumbrance*” means any charge, Claim, community property interest, condition, equitable interest, tax lien, lien, mortgage, deed of trust, option, pledge, security interest, right of first refusal or restriction of any kind, including any restriction on use, voting, transfer, receipt of income or exercise of any other attribute of ownership.

“*Environmental Laws*” means all Laws, Governmental Authorizations or Governmental Orders, and any judicial interpretation of any of the foregoing relating to health, any Hazardous Material, or the environment (including ground or air or water or noise pollution or contamination, and underground or aboveground tanks) and shall include the Solid Waste Disposal Act, 42 U.S.C. § 6901 et seq.; the Comprehensive Environmental Response, Compensation and Liability Act of 1980, 42 U.S.C. § 9601 et seq. (“*CERCLA*”), as amended by the Superfund Amendments and Reauthorization Act of 1986 (“*SARA*”); the Hazardous Materials Transportation Act, 42 U.S.C. § 1801 et seq.; the Federal Water Pollution Control Act, 33 U.S.C. § 1251 et seq.; the Clean Air Act, 42 U.S.C. § 7401 et seq.; the Toxic Substances Control Act, 15 U.S.C. § 2601 et seq.; the Safe Drinking Water Act, 42 U.S.C. § 300f et seq.; California Health and Safety Code § 25100 et seq.; and any other applicable state or federal environmental statutes, and all rules, regulations, orders and decrees now or hereafter promulgated under any of the foregoing, as any of the foregoing now exist or may be changed or amended or come into effect in the future.

“*Environmental Permits*” means licenses, permits, registrations, governmental approvals, agreements and consents which are required under or are issued pursuant to Environmental Law.

“*Environmental Requirement*” means any Environmental Law, written agreement or restriction (including any condition or requirement imposed by any insurance or surety company) applicable to the Real Property, as the same now exists or may be changed or amended or come into effect in the future, which pertains to health, any Hazardous Material, or the environment,

including ground, air, water or noise pollution or contamination, and underground or aboveground tanks.

“ERISA” has the meaning set forth in Section 4.18.

“Excluded Liabilities” has the meaning set forth in Section 2.4.

“Facilities” has the meaning set forth in the recitals of this Agreement.

“Financial Statements” has the meaning set forth in Section 4.4(a).

“GAAP” means United States generally accepted accounting principles, as in effect from time to time.

“Goodwill” means with respect to the Businesses, without limitation and by way of example, the intangible asset held by the Businesses that is associated with, related to or arising out of (i) the reputation of the Businesses, (ii) the relationship with its customers, (iii) the know-how of its employees, (iv) the contacts with its vendors, public officials, banking relationships and regulatory agencies, (v) the unrealized appreciation of its contracts (including contracts of employment) and rights in law or in equity not reflected in its accounting records (or reflected in its accounting records in part or in whole as “goodwill”), and (vi) the unrealized depreciation, amortization or abatement of the its liabilities to a value less than those reflected in its accounting records (or reflected in its accounting records in part or in whole as “goodwill”).

“Governmental Authorization” means any approval, consent, license, permit, waiver, registration or other authorization issued, granted, given, made available or otherwise required by any Governmental Entity or pursuant to Law.

“Governmental Entity” means any federal, state, local, foreign, international or multinational entity or authority exercising executive, legislative, judicial, regulatory, administrative or taxing functions of or pertaining to government.

“Governmental Order” means any judgment, injunction, writ, order, ruling, award or decree by any Governmental Entity or arbitrator.

“Grant Deed” means the Grant Deed in the form attached hereto as Exhibit A.

“Hazardous Material” means any substance, whether solid, liquid or gaseous: (i) which is listed, defined or regulated as a “hazardous waste,” “industrial waste,” “solid waste,” “hazardous substance,” “toxic substance,” “pollutant,” or “contaminant” as those or similar terms are defined, identified, or regulated under any Environmental Regulation; or (ii) which is or which contains asbestos, polychlorinated biphenyls, radon, urea formaldehyde, foam insulation, explosive or radioactive material, or motor fuel or other petroleum, petroleum hydrocarbon or petroleum products; or (iii) which causes or poses a threat to cause a contamination or nuisance on the Real Property or any adjacent property or a hazard to the environment or to the health of persons on the Real Property; or (iv) any substance that, whether by its nature or its use, is subject to regulation under any Environmental Laws or Governmental Entity that requires environmental investigation, remediation, or monitoring.

“*Hemet Business*” has the meaning set forth in the recitals of this Agreement.

“*Hemet Home*” has the meaning set forth in the recitals of this Agreement.

“*Indemnified Party*” has the meaning set forth in Section 10.3.

“*Indemnifying Party*” has the meaning set forth in Section 10.3.

“*Intellectual Property Rights*” means (i) rights in patents, patent applications and patentable subject matter, whether or not the subject of an application, (ii) rights in trademarks, service marks, trade names, trade dress and other designators of origin, registered or unregistered, (iv) trade secrets, (v) rights in Internet domain names, uniform resource locators and e-mail addresses and (vi) all other intellectual and industrial property rights of every kind and nature and however designated, whether arising by operation of Law, Contract, license or otherwise.

“*Justin Employment Agreement*” means the Employment Agreement between Justin Luyben and Carriage Funeral Holdings, Inc., a Delaware corporation, in the form attached hereto as Exhibit B.

“*Justin Non-Competition Agreement*” means the Non-Competition Agreement between Justin Luyben and Carriage Funeral Holdings, Inc., a Delaware corporation, in the form attached hereto as Exhibit C.

“*Knowledge*,” means, when used with respect to Seller and the Company, the knowledge Seller and of the Company or any officer or director of the Company, including Seller, or any knowledge that would have been acquired by any such Person upon appropriate inquiry and investigations.

“*Lake Elsinore Business*” has the meaning set forth in the recitals of this Agreement.

“*Lake Elsinore Home*” has the meaning set forth in the recitals of this Agreement.

“*Law*” means (i) all federal, state or local laws, regulations and rules (to the extent having the force of law) of any Governmental Entity, and (ii) all orders, decrees, rulings, awards, writs, judgments, statutes, ordinances, codes, rules, regulations and license of any Governmental Entity.

“*Liabilities*” means all indebtedness, obligations and other liabilities of the Businesses of any nature whatsoever, whether direct or indirect, matured or unmatured, absolute, accrued, contingent (or based on any contingency), known or unknown, fixed or otherwise, or whether due or to become due.

“*Litigation*” means any Claim, action, arbitration, mediation, audit, hearing, investigation, proceeding, litigation or suit (whether civil, criminal, administrative, investigative or informal) commenced, brought, conducted or heard by or before, or otherwise involving, any Governmental Entity or arbitrator or mediator.

“*Loss*” means any Litigation, Governmental Order, complaint, Claim, demand, damage, deficiency, penalty, fine, cost, amount paid in settlement, Liability, Tax, Encumbrance, loss, expense or fee, including court costs and attorneys’ fees and expenses.

“*Luyben Jr. Employment Agreement*” means the Employment Agreement between Thaddeus M. Luyben, Jr. and Carriage Funeral Holdings, Inc., a Delaware corporation, in the form attached hereto as Exhibit D.

“*Luyben Jr. Non-Competition Agreement*” means the Non-Competition Agreement between Thaddeus M. Luyben, Jr. and Carriage Funeral Holdings, Inc., a Delaware corporation, in the form attached hereto as Exhibit E.

“*Luyben Sr. Consulting Agreement*” means the Consulting and Non-Competition Agreement between Thaddeus M. Luyben, Sr. and Carriage Funeral Services of California, Inc., a California corporation, in the form attached hereto as Exhibit F.

“*Luyben Sr. Goodwill*” means, as it relates to or affects the Businesses, without limitation and by way of example, the intangible asset owned or possessed by Thaddeus M. Luyben, Sr. that is associated with, related to or arising out of (i) his name and reputation as it relates to each of the Businesses and (ii) his relationships with its customers.

“*Material Adverse Effect*” means any change, effect, event or condition, individually or in the aggregate, that has had, or, with the passage of time, could have, a material adverse effect on (i) the business, condition (financial or otherwise), results of operations, prospects or customer, supplier or employee relationships of each of the Businesses or (ii) the ability of Seller or the Company to consummate the transactions contemplated hereby or to perform its or his obligations hereunder.

“*Material Contract*” has the meaning set forth in Section 4.10.

“*New Lessor*” means The Fleming Family Limited Partnership, a California limited partnership.

“*New Sun City Ground Lease*” means that certain Ground Lease to be executed at or before Closing by and between New Lessor (or one of its Affiliates) and Buyer, as lessee, in form and substance acceptable to Buyer, in Buyer’s sole discretion.

“*Notice Period*” has the meaning set forth in Section 6.10.

“*Ordinary Course of Business*” means, with respect to each Business, the ordinary course of business of such Business consistent with past custom and practice.

“*Organizational Documents*” means (i) the articles or certificate of incorporation and the bylaws of a corporation, (ii) any charter or similar document adopted or filed in connection with the creation, formation or organization of a Person and (iii) any amendment to any of the foregoing.

“*Outside Closing Date*” has the meaning set forth in Section 9.1(e).

“*Party*” or “*Parties*” has the meaning set forth in the first paragraph of this Agreement.

“*Permitted Encumbrances*” means the list of permitted encumbrances to be determined prior to Closing that are mutually acceptable to Buyer and Seller.

“*Perris Business*” has the meaning set forth in the recitals of this Agreement.

“*Perris Home*” has the meaning set forth in the recitals of this Agreement.

“*Person*” means any individual, corporation, partnership, limited liability company, joint venture, estate, trust, association, organization, labor union, Governmental Entity or other entity.

“*Plans*” has the meaning set forth in Section 4.18.

“*Preneed Trust Funds*” has the meaning set forth in Section 6.10.

“*Purchase Price*” has the meaning set forth in Section 3.1.

“*Purchased Asset*” has the meaning set forth in Section 2.1.

“*Real Property*” has the meaning set forth in Section 4.20.

“*Release*” has the meaning set forth in CERCLA.

“*Remedies Exception*,” means, when used with respect to any Person, performance of such Person’s obligations except to the extent enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or other laws affecting the enforcement of creditors’ rights generally and by general equitable principles.

“*Restricted Business*” has the meaning set forth in Section 6.6(a).

“*Retained Assets*” has the meaning set forth in Section 2.2.

“*Retained At-Need Funeral Receivables*” has the meaning set forth in Section 2.1(a).

“*ROFR Agreement*” has the meaning set forth in Section 3.5(a)(xvi).

“*Rules*” has the meaning set forth in Section 11.13(b).

“*Seller*” has the meaning set forth in the first paragraph of this Agreement.

“*Seller Disclosure Schedule*” has the meaning set forth in Article IV.

“*Seller Indemnified Parties*” has the meaning set forth in Section 10.2.

“*Sun City Business*” has the meaning set forth in the recitals of this Agreement.

“*Sun City Home*” has the meaning set forth in the recitals of this Agreement.

“*Sun City Lease*” means that certain Contract for Erection and Lease of Mortuary Building and Facilities, dated August 12, 1969, made and entered into by and between Benjamin Fleming and Genevieve Gloria Fleming (collectively “*Lessor*”) and John D. Flanagan and Honorine T. Flanagan (collectively “*Lessee*”), as amended by that certain Addendum to Lease, dated March 10, 1974, as ratified by that certain Modification and Ratification of Lease, dated July 1, 1994, as assigned by Lessee to Seller pursuant to that certain Sublease Agreement, dated September 17, 2002, as the same may have been further amended and/or modified.

“*Tangible Personal Property*” has the meaning set forth in Section 4.21.

“*Taxes*” means all taxes, charges, fees, levies or other assessments, including all net income, gross income, gross receipts, sales, use, ad valorem, transfer, franchise, profits, license, withholding, payroll, employment, social security, unemployment, excise, estimated, severance, stamp, occupation, property or other taxes, customs duties, fees, assessments or charges of any kind whatsoever, including all interest and penalties thereon, and additions to tax or additional amounts imposed by any Governmental Entity upon the Businesses.

“*Tax Return*” means any return, report or statement required to be filed with respect to any Tax (including any attachments thereto), including any information return, Claim for refund, amended return or declaration of estimated Tax.

“*Territory*” has the meaning set forth in Section 6.6(a).

“*Third Party Claim*” has the meaning set forth in Section 10.3(a).

“*Title Company*” has the meaning set forth in Section 8.2(h).

“*Transaction Documents*” means the Justin Employment Agreement, Justin Non-Competition Agreement, the Luyben Jr. Employment Agreement, the Luyben Jr. Non-Competition Agreement, and the Luyben Sr. Consulting Agreement.

“*Treasury Regulations*” means the rules and regulations under the Code.

1.2 Interpretation. Unless the context of this Agreement otherwise requires:

(a) words of any gender include each other gender;

(b) words using the singular or plural number also include the plural or singular number, respectively;

(c) the terms “hereof,” “herein,” “hereby,” “hereto,” and similar words refer to this entire Agreement and not to any particular Article, Section, Clause, Exhibit or Schedule or any subdivision of this Agreement;

(d) references to “Article,” “Section,” “Clause,” “Exhibit” or “Schedule” are to the Articles, Sections, Clauses, Exhibits and Schedules, respectively, of this Agreement;

(e) the words “include” or “including” shall be deemed to be followed by “without limitation” or “but not limited to” whether or not such words are followed by such phrases or phrases of like import; and

(f) references to “this Agreement” or any other agreement or document shall be construed as a reference to such agreement or document as amended, modified or supplemented and in effect from time to time and shall include a reference to any document which amends, modifies or supplements it. Whenever this Agreement refers to a number of days, such number shall refer to calendar days unless Business Days are specified.

ARTICLE II.

PURCHASE AND SALE OF ASSETS

2.1 Transfer of Assets by Seller and the Company. In reliance upon the representations, warranties, covenants and agreements contained herein and upon the terms and subject to the conditions hereinafter set forth and except as set forth in Section 2.2, at the Closing, Seller shall, and shall cause the Company to, sell, assign, transfer, convey and deliver to Buyer, and Buyer shall purchase and accept from Seller and the Company (as the case may be), free and clear of any Encumbrances whatsoever (except for Permitted Encumbrances) all of Seller’s and the Company’s rights, benefits, title and interests in and to the properties, assets, rights, claims and contracts principally relating to, or principally used in or necessary for the conduct of, the Businesses (the “*Purchased Assets*”), including the following:

(a) all preneed accounts and notes receivable of the Businesses, and all at-need accounts receivables of the Businesses, other than the accounts receivable of the Businesses arising from the at-need sale of funeral services and merchandise to the extent services have been performed or merchandise has been delivered in which the date of death has occurred prior to the Closing Date, whether such receivables are payable from insurance proceeds, trust funds or other form of payment (collectively, “*Retained At-Need Funeral Receivables*”);

(b) inventories of caskets, vaults, urns, accessories and monuments of the Businesses and all other goods and inventories of the Businesses;

(c) fee simple title to all of the Real Property and valid leasehold interest in the New Sun City Ground Lease;

(d) machinery, equipment, motor vehicles, furniture, fixtures, supplies, tools and other fixed assets and property, plant and equipment, including those described on Section 4.21 of the Seller Disclosure Schedule;

(e) all preneed Contracts of the Businesses, all cash, securities and other investments to fund preneed Liabilities, and all rights under policies of insurance available to fund preneed Liabilities;

(f) to the extent transferable and subject to any required Consents, all rights and benefits in and under the Contracts principally relating to, or principally used in or necessary for the conduct of the Businesses to which the Company or any of its Affiliates are bound or by

which the Purchased Assets are bound, including the Contracts described on Section 4.10 of the Seller Disclosure Schedule, the Sun City Lease and the New Sun City Ground Lease;

(g) all rights under warranties from suppliers of the Businesses, except to the extent related to Excluded Liabilities;

(h) all rights as trustor of each trust account and pursuant to each related trust agreement, as further described on Section 4.11 of the Seller Disclosure Schedule;

(i) all of the Goodwill of the Businesses;

(j) all rights to the names “Evans Brown Mortuaries,” “Hemet Valley Mortuary,” and all other trade names used in the Businesses, together with all derivatives thereof, and all trademarks, trade names, service marks, service names, patents, processes, copyrights, know-how and similar intangible rights, and all Goodwill associated with the foregoing and otherwise with the Businesses;

(k) all permits and licenses of the Businesses and/or Facilities, to the extent transferable;

(l) all books, records, brochures and literature of the Businesses (whether in tangible or electronic format), customer lists, computers and computer software, the telephone and fax numbers and listings for the Businesses, and all internet domain names;

(m) to the extent transferable, and subject to any required consents, all Governmental Authorizations;

(n) all of the Luyben Sr. Goodwill;

(o) all rights, privileges, claims, demands, choses in action, prepayments, deposits, refunds, claims in bankruptcy, indemnification agreements with, and indemnification rights against, third parties, offsets and other claims;

(p) all Tangible Personal Property; and

(q) all other assets, rights and properties owned or leased by the Company that are principally used in or necessary for conduct of the Businesses at the time of Closing.

2.2 Retained Assets. Notwithstanding any other provision of this Agreement, Seller, the Company and their respective Affiliates shall retain, and Buyer shall not acquire, the following assets, properties, rights and interests of Seller, the Company or their respective Affiliates, which shall not be included in the Purchased Assets (collectively referred to hereinafter as the “*Retained Assets*”):

(a) all cash on hand or on deposit, including bank account balances, certificates of deposit and marketable securities, excluding, however, cash, securities and other investments to fund preneed Liabilities;

(b) all Retained At-Need Funeral Receivables;

(c) the personal vehicles of Seller set forth on Section 2.2(c) of the Seller Disclosure Schedule; and

(d) any other assets and properties that are not principally relating to, or principally used in or necessary for the conduct of, the Businesses, including those items set forth on Section 2.2(d) of the Seller Disclosure Schedules.

2.3 Assumption of Liabilities. Simultaneously with the Closing, Buyer shall assume and be liable for in accordance with their respective terms only the following Liabilities of Seller or the Company, as the case may be, as they relate to the Businesses (collectively, the “*Assumed Liabilities*”):

(a) all Liabilities under those preneed Contracts of the Businesses that are included in the Purchased Assets, provided that as of the Closing such Liabilities are funded by trust or insurance to the full extent required under applicable Law;

(b) subject to Section 7.1, all Liabilities of Seller or the Company, as the case may be, arising after the Closing Date under the Contracts constituting Purchased Assets;

(c) all Liabilities in respect of employee reserves and residuals of the Company, as further described on Section 4.17 of the Seller Disclosure Schedule;

(d) all Liabilities of the Company under any Governmental Authorization constituting a Purchased Asset to the extent arising after the Closing Date;

(e) all Liabilities of the Company as trustor of each trust account (preneed) and pursuant to each related trust agreement, as further described on Section 4.11 of the Seller Disclosure Schedule; and

(f) vacation and sick leave of employees of the Businesses accrued in the Ordinary Course of Business, subject to proration as described in Section 3.2 below.

The assumption by Buyer of the Assumed Liabilities shall not enlarge any rights or remedies of any third parties under any contracts or arrangements so assumed. Nothing herein shall prevent Buyer from contesting in good faith any of the Assumed Liabilities.

2.4 Limitations on Assumption. Notwithstanding anything herein to the contrary, Buyer has not agreed to pay or discharge, shall not be required to assume and shall not have any Liability, of Seller, the Company or any other Person, the assumption of which by Buyer is not expressly provided for in this Agreement. Without limiting the foregoing, Buyer shall not assume under this Agreement, there shall be excluded from the Assumed Liabilities and Seller, the Company and their respective Affiliates shall retain, pay and discharge, the following (the “*Excluded Liabilities*”):

(a) any notes or accounts payable or other Liabilities for borrowed money;

(b) any trade payables of any kind, regardless of whether entered into in the Ordinary Course of Business, non-compete payments, and amounts payable to any employee benefit plan or to any preneed trust;

(c) the Liabilities under any warranties to customers with respect to goods or products sold or services provided by Seller, the Company or any of their respective Affiliates prior to the Closing Date;

(d) all Liabilities of Seller, the Company or any of their respective Affiliates for income Taxes and all deficiencies, assessments, charges, interest and penalties associated therewith imposed by the United States, any taxing authority outside the United States or any state or local instrumentality or authority within the United States relating to or accrued in any period prior to the Closing;

(e) any Liabilities related to or arising in connection with the Retained Assets, whether arising before, on or after the Closing Date;

(f) any Liability of Seller, the Company or any of their respective Affiliates, or any of their respective directors, officers, employees, stockholders or agents, arising out of, or relating to, this Agreement or the transactions contemplated hereby;

(g) any Liability based in whole or in part on events or conditions occurring or existing in connection with, or arising out of, the ownership or operation of, or any act, omission or circumstances relating to, any of the Businesses, the Purchased Assets or Assumed Liabilities prior to the Closing Date;

(h) any Liabilities in respect of Claims or Litigation, pending or threatened, and Claims, whether or not presently asserted, arising out of, relating to or otherwise in any way in respect of the ownership or operation of, or of any act, omission or circumstances relating to, any of the Businesses or the Purchased Assets prior to the Closing Date, including personal injury Claims, product liability Claims, Claims of environmental damage, Claims of hazards to health, strict liability, toxic torts, enforcement proceedings, cleanup orders and other similar Claims instituted by private parties or any Governmental Entity; and

(i) any other Liability not specifically included within the Assumed Liabilities.

ARTICLE III.

CONSIDERATION AND CLOSING

3.1 Purchase Price. At Closing, the purchase price for the Purchased Assets shall be \$10,000,000.00 (the "*Purchase Price*") in cash or certified funds by wire transfer by Buyer to the Title Company on or before the Closing Date, of which (a) \$3,000,000.00 shall be paid by Buyer to the Company with respect to certain of the Purchased Assets and the covenants of the Company contained in Article VI and (b) \$7,000,000.00 shall be paid by Buyer to Seller with respect to the Real Property and the Luyben Sr. Goodwill.

3.2 Certain Prorations . All prepaid expenses and deposits, and all expenses for which Liability has accrued by whose payment is not yet due as of Closing (including (a) utility deposits and charges, including electricity, water and sewer charges; (b) transferable business and license fees, including any retroactive adjustments thereof; (c) real and personal property Taxes in connection with the Purchased Assets; (d) employee wages and operating expenses; and (e) similar prepaid and deferred items), together with all revenues and expenses arising from the operation of the Businesses, shall be prorated and adjusted between Seller (as the case may be) and Buyer in accordance with the principle that Seller and the Company shall retain all revenues and shall be responsible for all expenses allocable to the conduct of the Businesses up to 11:59 p.m. on the day before the Closing Date, and Buyer shall be entitled to all revenues and shall be responsible for all expenses allocable to the conduct of the Businesses after 12:01 a.m. on the Closing Date. Utility services will be transferred to Buyer's name on the Closing Date. The apportionments set forth in this Section 3.2 owed by Seller or the Company shall be deducted from the Purchase Price. The provisions of this Section 3.2 shall survive the Closing. If the actual amounts to be prorated are not known as of the Closing Date, the prorations shall be made on the basis of the best evidence then available, and thereafter, within 30 days after actual figures are received, a cash settlement will be made between Seller and Buyer.

3.3 Taxes; Closing Costs. Any sales or transfer Taxes that may be payable in connection with the sale of the Purchased Assets under this Agreement shall be borne by the Company. Buyer is hereby authorized to conduct any environmental audits or assessments on the Real Property, the same will be at Buyer's expense; provided, however, that subject to Section 8.2(g), Seller shall cause the Company to perform the remedial action recommended pursuant to such audits and assessments. All such remedial action will be performed to Buyer's satisfaction and, subject to Section 8.2(g), Seller and the Company shall pay for all expenses of such remedial actions to the extent such expenses do not exceed \$25,000.00. Seller and Buyer further agree to split equally all fees and costs for the Real Property survey(s) provided for in Section 8.2(i) and all premiums and other costs associated with issuing the title policy provided for in Section 8.2(h). The provisions of this Section 3.3 shall survive the Closing.

3.4 The Closing.

(a) Except as herein provided, the Closing of the transactions contemplated by this Agreement (the "*Closing*") will take place at the offices of Greenberg Traurig, LLP at 1000 Louisiana Street, Suite 1800 Houston, Texas and/or the Title Company, as necessary, on the third Business Day following the date on which all of the conditions contained in Article VII (other than those conditions relating to actions to be taken at the Closing) have been satisfied or, in the case of Sections 8.1 and 8.2, waived by Buyer, or, in the case of Sections 8.1 and 8.3, waived by Seller (the "*Closing Date*"), or at such other place and on such other date as may be mutually agreed upon in writing by Buyer and Seller, in which case "*Closing Date*" means the date so agreed.

(b) All proceedings to be taken and all documents to be executed and delivered by all Parties at the Closing shall be deemed to have been taken and executed simultaneously, and no proceedings shall be deemed taken nor any documents executed or delivered until all have been taken, executed and delivered.

3.5 Closing Deliveries.

(a) Closing Deliveries of Seller and the Company. At the Closing, Seller shall deliver, or cause to be delivered, to Buyer, the following:

(i) *General Bill of Sale.* A general bill of sale (the “*General Bill of Sale*”), duly executed by the Company.

(ii) *General Assignment and Assumption Instrument.* A general assignment and assumption instrument (the “*General Assignment and Assumption Instrument*”), duly executed by the Company.

(iii) *Grant Deeds.* Grant Deeds (in substantially the same form as the Grant Deed attached hereto as Exhibit A) with respect to each parcel of Real Property, duly executed and notarized by Seller, vesting fee simple title in Buyer, together with releases of all Encumbrances (other than Permitted Encumbrances) on such property and in recordable form as determined by the Title Company (collectively, the “*Deeds*”).

(iv) *Deed of Improvements.* A deed conveying all rights, title and interests in and to the improvements located at the Sun City Home, duly executed by the Company, together with releases of all Encumbrances (other than Permitted Encumbrances) on such property duly executed and notarized by the appropriate party, and in recordable form as determined by the Title Company.

(v) *Termination of Sun City Lease.* A termination of the Sun City Lease, duly executed by and among Lessor, Lessee and Seller, in form and substance acceptable to Buyer.

(vi) *New Sun City Ground Lease.* The New Sun City Ground Lease, duly executed by New Lessor.

(vii) *Releases of Encumbrances.* Releases of liens evidencing the discharge and removal of all Encumbrances on the Purchased Assets, other than Permitted Encumbrances.

(viii) *Code § 1445 Affidavit.* A certificate from each of Seller and the Company, if required, in form described in Treasury Regulation Section 1.1445-2(b)(iii)(B), certifying its compliance with Treasury Regulation Section 1.445-2(b) that, as of the Closing Date, such person is not a “foreign person” within the meaning of Section 1445.

(ix) *Delivery of Records and Contracts.* All of the leases, contracts, commitments and rights of the Businesses constituting a portion of the Purchased Assets, with such assignments thereof and consents to assignment as Buyer shall deem necessary to assure Buyer of their full benefit; actual possession and operating control of the Purchased Assets and all of the records, books and other data of the Businesses, including customer lists and customer contact information.

(x) *Delivery of Pre-Need Trust Funds and Accounts*. Subject to Section 6.10, all documents, deeds, endorsements, assignments or other instruments transferring and assigning all of the preneed trust accounts and funds referred to in Section 4.11, including the obtaining of Governmental Authorization and third party Consents and the substitution of trustees.

(xi) *Title Policy*. The irrevocable commitment from the Title Company to issue (A) an owner's title policy for the Perris Home, the Lake Elsinore Home, and the Hemet Home and (B) a leasehold title policy for the Sun City Home, each in an amount and form determined by Buyer.

(xii) *Opinion of Seller Counsel*. An opinion of Stephens & Kray, counsel for Seller, dated the Closing Date, in substantially the form of Exhibit 3.5(a)(xii);

(xiii) *Justin Agreements*. An executed counterpart of each of the Justin Employment Agreement and the Justin Non-Competition Agreement, duly executed by Justin Luyben;

(xiv) *Luyben Sr. Agreements*. An executed counterpart of the Luyben Sr. Consulting Agreement, duly executed by Seller.

(xv) *Luyben Jr. Agreements*. An executed counterpart of each of the Luyben Jr. Employment Agreement and the Luyben Jr. Non-Competition Agreement, duly executed by Thaddeus M. Luyben, Jr.

(xvi) *ROFR Agreement*. An executed counterpart of the Right of First Refusal and Deed Restriction Agreement in substantially the form attached hereto as Exhibit 3.5(a)(xvi) (the "*ROFR Agreement*"), duly executed by Seller. *Other Instruments*. All such other deeds, endorsements, assignments or other instruments, in form and substance reasonably satisfactory to Buyer, as shall be necessary to vest in Buyer fee simple title to the Purchased Assets.

(b) Closing Deliveries of Buyer. At the Closing, Buyer shall deliver, or cause to be delivered, to Seller, the following:

(i) *Payment of Purchase Price*. Payment to Seller and the Company of the Purchase Price in same day funds (in U.S. dollars) by wire transfer based on wiring instructions given by Seller to Buyer at least three Business Days prior to the Closing Date.

(ii) *Bill of Sale*. The General Bill of Sale, duly executed by Buyer.

(iii) *General Assignment and Assumption Instrument*. The General Assignment and Assumption Instrument, duly executed by Buyer.

(iv) *New Sun City Ground Lease*. The New Sun City Ground Lease, duly executed by Buyer.

(v) *Opinion of Buyer Counsel*. An opinion of Greenberg Traurig, LLP, special counsel for Buyer, dated the Closing Date, in substantially the form of Exhibit 3.5(b)(vi).

(vi) *Luyben Family Agreements*. An executed counterpart of each of the Luyben Sr. Consulting Agreement, the Luyben Jr. Employment Agreement, the Luyben Jr. Non-Competition Agreement, the Justin Employment Agreement, and the Justin Non-Competition Agreement, each duly executed by Carriage Funeral Holdings, Inc. or Carriage Funeral Services of California, Inc., as required.

(vii) *ROFR Agreement*. An executed counterpart of the ROFR Agreement, duly execute by Buyer.

ARTICLE IV.

REPRESENTATIONS AND WARRANTIES OF SELLER AND THE COMPANY

Except as set forth in the disclosure schedules (the “*Seller Disclosure Schedule*”) delivered by Seller to Buyer prior to or concurrently with the execution of this Agreement, Seller and the Company hereby jointly and severally represent and warrant to Buyer as follows:

4.1 Incorporation and Power.

(a) Seller has all necessary power and authority to execute, deliver and perform this Agreement and the Ancillary Agreements to which he is a party, to carry out its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby.

(b) The Company is a corporation duly organized, validly existing and in good standing under the Laws of the jurisdiction of its organization, and has all necessary power and authority to execute, deliver and perform the Ancillary Agreements to which it is a party, to carry out its obligations thereunder and to consummate the transactions contemplated thereby. the Company is duly licensed and qualified to do business and is in good standing in each jurisdiction in which the properties owned or leased by it or the operation of its business makes such licensing or qualification necessary.

4.2 Valid and Binding Agreement. The execution and delivery by Seller of this Agreement and each Seller and the Company of the Ancillary Agreements to which it is a party, the performance by each of Seller and the Company of its obligations hereunder and thereunder and the consummation by each of Seller and the Company of the transactions contemplated hereby and thereby have been duly authorized by all requisite action on the part of Seller and the Company, as the case may be. This Agreement has been, and upon their execution, the Ancillary Agreements to which it is a party shall have been, duly executed and delivered by Seller or the Company, as the case may be, and (assuming due authorization, execution and delivery by Buyer) this Agreement constitutes, and upon its execution the Ancillary Agreements to which it is a party shall constitute, legal, valid and binding obligations of Seller and the Company, as the case may be, enforceable against Party in accordance with their respective terms, subject to the Remedies Exception.

4.3 No Conflicts and Consents. The execution, delivery and performance of this Agreement and the Ancillary Agreements by each of Seller and the Company do not and will not:

(a) violate, conflict with or result in the breach of any provision of the Organizational Documents of the Company;

(b) conflict with or violate (or cause an event which would have a Material Adverse Effect as a result of) any Law or Governmental Order applicable to such Party, or any of its assets, properties or businesses, including the Businesses;

(c) conflict with, result in any breach of any of the provisions of, constitute a default (or any event that would, with the passage of time or the giving of notice or both, constitute a default) under, result in a violation of, increase the burdens under, result in the termination, amendment, suspension, modification, abandonment or acceleration of payment (or any right to terminate) or require a Consent under any Contract or Governmental Authorization that is either binding upon or enforceable against such Party;

(d) result in the creation of any Encumbrance upon the Facilities or any of the Purchased Assets; or

(e) require any Governmental Authorization.

4.4 Financial Statements.

(a) Seller has delivered to Buyer unaudited (compiled) statements of assets, liabilities and stockholders' equity-income tax basis of the Businesses at December 31, 2006, 2005 and 2004 and the related unaudited (compiled) statements of revenues, expenses and retained earnings and cash flows-income tax basis for the respective 12-month periods of operations of Businesses then ended, together with the footnotes thereto (the "*Annual Financial Statements*" or the "*Financial Statements*"). All of such Financial Statements are true and correct, have been prepared on an accrued income tax basis of accounting, which is a comprehensive basis of accounting other than GAAP, and are true and correct and present fairly the respective financial position, results of operations and cash flows of the Businesses at the respective dates and for the respective periods indicated.

(b) Except as set forth in such Financial Statements, the Businesses have no, and none of their assets or properties are subject to any, Liabilities other than unsecured trade accounts, payable and accrued expenses arising in the Ordinary Course of the Business, and there is no known basis for any present or future Litigation, charge, complaint, Claim or demand against any of the assets or properties giving rise to any Liability, except Liabilities that have arisen after the date of the Financial Statements in the Ordinary Course of Business, none of which is a Liability for breach of Contract, breach of warranty, tort, infringement, Litigation or violation of Governmental Order, Governmental Authorization or Law.

(c) Section 4.4 of the Seller Disclosure Schedule accurately sets forth for the 12-month periods ended December 31, 2006, 2005 and 2004 and for the eight months ended August 31, 2007, for each of the Businesses, the number of contracts entered into in which

human remains have been prepared for final disposition or delivery, and among such contracts, the number or percentage in which disposition is by burial, cremation or other means.

4.5 Books and Records. All books and records of the Businesses are true, correct and complete, have been maintained in accordance with sound business practice, including the maintenance of an adequate system of internal controls, and in accordance with all Laws and other requirements applicable to the Businesses.

4.6 Absence of Certain Developments. Except as set forth on Section 4.6 of the Seller Disclosure Schedule, since August 31, 2007 the Company has operated each Business in the Ordinary Course of Business and, without limiting the foregoing, since August 31, 2007, there has not been:

(a) any Material Adverse Effect;

(b) any sale, lease, transfer or assignment of properties or assets (real, personal or mixed or tangible or intangible), other than sales of inventory in the Ordinary Course of Business;

(c) any Contract (or series of related Contracts) entered into outside the Ordinary Course of Business;

(d) any material Loss (whether or not covered by insurance) of or to the Purchased Assets;

(e) any acceleration, suspension, termination, modification or cancellation of any Contract or permits (or series of related Contracts or permits) by any party (including Seller or the Company) outside the Ordinary Course of Business;

(f) any Encumbrance imposed on any Purchased Assets;

(g) any capital expenditure (or series of related capital expenditures) outside the Ordinary Course of Business;

(h) any capital investment in, any loan to, or any acquisition of the securities or assets of, any other Person (or series of related capital investments, loans and acquisitions) outside the Ordinary Course of Business or acquired (by merger, exchange, consolidation, acquisition of stock or assets or otherwise) any Person;

(i) any note, bond or other debt security issued, or any indebtedness created, incurred, assumed or guaranteed for borrowed money (including advances on existing credit facilities) or capitalized lease obligation;

(j) any delay, postponement, or acceleration of any payment of accounts payable or other liabilities or the receipt of any accounts receivable, in each case outside the Ordinary Course of Business;

- (k) any cancellation, compromise, waiver or release of any right or Claim (or series of related rights or Claims);
- (l) any discharge or satisfaction of any Encumbrance or payment of any Liability, other than current liabilities paid in the Ordinary Course of Business;
- (m) to the Knowledge of Seller and the Company, any new competitor that has built, commenced to build or announced intentions to establish or build a funeral home, mortuary, crematory or cemetery in direct competition with the Businesses;
- (n) in connection with the Businesses, created, incurred or assumed any indebtedness or other material Liability, other than in the Ordinary Course of Business;
- (o) written-down any inventory or written-off of any receivable, except for write-downs and write-offs in the Ordinary Course of Business;
- (p) increased the wages, salaries, benefits or other compensation of any employee (except for customary increases based on term of service or promotion of non-salaried employees or other increases in the ordinary course of business);
- (q) made or changed any express or deemed election for Tax purposes or any offer to settle or compromise or any settlement or compromise of any liability with respect to Taxes;
- (r) any change in accounting principles or practices from those utilized in the preparation of the Financial Statements; and
- (s) any Contract to take any of the actions described in this Section 4.6.

4.7 Inventory; Accounts Receivable. All inventories of the Businesses are saleable or usable in the Ordinary Course of Business at usual and customary prices, subject to normal returns and markdowns consistent with past practice. All accounts receivable of the Businesses are valid and legally enforceable obligations of the account parties and are not subject to any Claim of offset or deduction. At the Closing, Seller shall deliver to Buyer lists, certified by them to be complete and correct, of all of the inventory and accounts receivable of each of the Businesses as of the Closing Date.

4.8 Tax Matters.

(a) Each of the Company and Seller (i) has filed (or there has been filed on its behalf) with the appropriate Governmental Entity all Tax Returns required to be filed, and all such Tax Returns are true and correct and (ii) has paid all Taxes due and payable.

(b) There are no outstanding waivers in writing or comparable consents regarding the application of any statute of limitations in respect of Taxes of the Businesses.

(c) There is no Claim or assessment pending or proposed in writing with respect to Taxes of the Businesses, and no facts exist that would constitute grounds for any such actions.

(d) There are no Encumbrances for Taxes upon the assets or the properties, except for Encumbrances relating to current Taxes not yet due.

(e) All Taxes that Seller or the Company is required by Law to withhold or to collect for payment have been duly withheld and collected, and have been paid or accrued, reserved against and entered on the books of the Businesses in accordance with GAAP.

(f) True and correct copies of Tax Returns filed by Seller and Seller, as the case may be, for each of the last three years have been furnished to Buyer.

4.9 Intellectual Property. Section 4.9 of the Seller Disclosure Schedule sets forth, for the Intellectual Property owned by the Businesses and included in the Purchased Assets, a complete and accurate list of all material U.S. and foreign:

(a) patented or registered Intellectual Property Rights;

(b) pending patent applications and applications for other registrations of Intellectual Property Rights filed by or on behalf of the Businesses;

(c) material licenses and other rights granted by Seller or the Company to any third party with respect to any Intellectual Property Rights; and

(d) all material licenses and other rights granted by any third party to the Businesses with respect to any Intellectual Property Rights. To the Knowledge of Seller and the Company, each of the Businesses owns and possesses or has the right to use, pursuant to a valid and enforceable license, all Intellectual Property Rights necessary for the operation of the Businesses as presently conducted, free and clear of all Encumbrances. Neither Business is charged with infringement or misappropriation of any Intellectual Property Rights of any other Person, nor, to Seller's and the Company's Knowledge, has any Person infringed upon, misappropriated or conflicted with any Intellectual Property Rights owned by Seller or the Company and used in the Businesses.

4.10 Contracts.

(a) Section 4.10 of the Seller Disclosure Schedule sets forth a complete description of:

(i) all Contracts evidencing any money borrowed by the Businesses or the creation or existence of any Encumbrance against any of the Purchased Assets of the Businesses, and all Contracts relating to any debt secured in whole or in part by any such Encumbrances;

(ii) all collective bargaining agreements, employment contracts, noncompetition agreements and other Contracts relating to any present or former owners or employees of the Businesses;

(iii) all Contracts involving the sharing of profits involving Seller, the Company or any of the Businesses;

(iv) all (i) Contracts for capital expenditures for the Businesses involving obligations aggregating in excess of \$4,000; (ii) Contracts under which personal property is leased by the Businesses and which are not cancelable by either party thereto without penalty upon notice of 30 days or less or pursuant to which rentals exceed \$1,000 per annum or \$4,000 in the aggregate; or (iii) Contracts of the Businesses that do not terminate or are not terminable by the Businesses upon notice of 30 days or less or which involves an obligation on its part in excess of \$1,000 per annum or \$4,000 in the aggregate; and

(v) all other Contracts of the Businesses entered into outside the Ordinary Course of Business.

(b) Each Contract required to be described in Section 4.10 of the Seller Disclosure Schedule is a “*Material Contract*”. Each Material Contract is valid and binding, currently in force and enforceable in accordance with its terms, subject to the Remedies Exception. Seller or the Company, as the case may be, has performed all obligations required to be performed by it in connection with each Material Contract. Neither Seller nor the Company has received any notice of any Claims of default under or termination of any Material Contract. Neither Seller nor the Company has any present expectation or intention of not fully performing any obligation pursuant to any Material Contract, and there is no breach, anticipated breach or default by any other party to any Material Contract. There are no renegotiations of, attempts to renegotiate or outstanding rights to renegotiate any material terms of any Material Contract, and no Person has made written demand for such renegotiation. A true and correct copy of each document listed on Section 4.10 of the Seller Disclosure Schedule has been made available to Buyer by Seller.

4.11 Preneed Contracts and Trust Accounts.

(a) Section 4.11 of the Seller Disclosure Schedule accurately lists:

(i) all preneed agreements of each of the Businesses, including contract number, customer name, sale date, contract price and other data normally included in the Company’s internal records in a compilation of preneed agreements;

(ii) a list of all insurance policies used to fund preneed agreements, including policy number, insured and owner names, issue date, current and face amount of insurance, and other data normally included in the Company’s internal records in a compilation of insurance policies (and for each carrier providing such insurance benefits, the contact information for the carrier, including contact person, address and phone number); and

(iii) a list and summary of each trust account relating to the Businesses, with information including (A) name of such trust account, (B) type of such trust account, (C)

trustee of such trust account, (D) trustor of such trust account, (E) date of the controlling trust agreement for such account, (F) account number(s) for such trust account, (G) tax identification number for such trust account, (G) balance of each trust account (at cost and market value) [and (H) the amounts of such trust account allocated to (1) service and other items and (2) merchandise]. Seller has separately provided to Buyer true and complete copies of the trust agreements for such trusts, as amended and currently in effect; and copies of the following as of the most recent date available (but in no event older than 45 days) and for each of 2005 and 2006: bank statements or other periodic report of the trustee for each trust, Tax Returns, and the audit or other reports furnished to or prepared by the state regulatory agency which oversees such trusts, and all work papers supporting such reports.

(iv) a trust detail report that itemizes by each trust agreement for the trust accounts set forth in Section 4.11 of the Seller Disclosure Schedule information including (A) principal amount for such trust account, (B) income and earnings for such trust account, (C) withdrawals from such trust account and (D) total contract liability with respect to such trust account.

(b) All preneed agreements required to be listed on Section 4.11 of the Seller Disclosure Schedule:

(i) have been entered into in the Ordinary Course of Business at regular retail prices, or pursuant to a sales promotion program, solely for use by the named customers and members of their families on terms not more favorable than shown on the specimen contracts which have been delivered to Buyer;

(ii) are subject to the rules and regulations of the Businesses as now in force (copies of which have been delivered to Buyer); and

(iii) are in full force and effect, subject to no offsets, claims or waivers, and neither the Company nor such customer is in default thereunder. All funds received by the Company under preneed agreements have been deposited in the appropriate accounts and are fully funded, administered and reported in accordance with the terms thereof and as required by applicable Laws. The aggregate market value of such preneed accounts, trusts and other deposits is equal to or greater than the aggregate preneed Liability related thereto. The services heretofore provided by the Businesses have been rendered in a professional and competent manner consistent with prevailing professional standards, practices and customs.

(c) Seller or the Company, as the case may be, has all rights as trustor of each trust account listed in Section 4.11 of the Seller Disclosure Schedule and under each trust agreement related to each such trust accounts.

4.12 Litigation. No Litigation is pending or, to the Knowledge of Seller or the Company, threatened by or against Seller or the Company or otherwise affecting the Businesses, or any of the Purchased Assets, at Law or in equity or before or by any Governmental Entity. The Company is not subject to, and its assets and properties are not affected by, any continuing Governmental Order nor is the Company in default with respect to any Governmental Order.

4.13 Insurance and Claims. The Company maintains such policies of insurance in such amounts, and which insure against such losses and risks, as are generally maintained for comparable businesses and properties. There are no currently pending Claims under any such policies, and no insurer has denied any material Claim of the Company under any policy of insurance within the preceding three years. Valid policies for such insurance will be outstanding and duly in force at all times prior to the Closing.

4.14 Governmental Authorizations. Section 4.14 of the Seller Disclosure Schedule lists all Governmental Authorizations currently held by or issued to the Company, and by each employee of the Company in connection with the Businesses which are all that are necessary or appropriate for the operation of the Businesses. All such items are in full force and effect, and the Company has complied in all material respects with all Governmental Authorizations applicable to it.

4.15 Compliance with Laws. The Company has complied in all material respects with all applicable Laws and Governmental Orders (including all occupational safety and health rules, regulations and Laws, and Laws and regulations applicable to preneed contracts and trust accounts, including the so-called "FTC Funeral Rule"). The Company is not relying on any exemption from or deferral of any Law, Governmental Order or Governmental Authorization that would not be available to the Buyer after the Closing.

4.16 Environmental Matters.

(a) Each of Seller and the Company is not in violation of any Environmental Laws and/or Environmental Permits, which violation would have a Material Adverse Effect. The Businesses possesses all Environmental Permits that are required for the operation of business, where the failure to possess such Environmental Permits would have a Material Adverse Effect, and is in compliance with the provisions of all such Environmental Permits, except where the failure to so comply would not have a Material Adverse Effect. A copy of any notice, citation, inquiry or complaint which Seller or the Company has received in the past three years of any alleged violation of any Environmental Law or Environmental Permit is contained in Section 4.16 of the Seller Disclosure Schedule.

(b) Neither Seller nor the Company has received any notice, report or other information regarding any Liabilities relating to the Businesses or any of the Real Property arising under Environmental Laws.

(c) None of the following exists on any portion of the Real Property:

- (i) underground storage tank or surface impoundments;
- (ii) asbestos-containing material in any form or condition; or
- (iii) materials or equipment containing polychlorinated biphenyls.

(d) Neither Seller nor the Company has treated, stored, disposed of, arranged for or permitted the disposal of, transported, handled, or Released any substance, including any Hazardous Materials, or owned or operated any facility or property, so as to give rise to liabilities

for response costs, natural resource damages or attorneys fees pursuant to CERCLA or similar state Environmental Laws, except for formaldehyde and other chemicals used in the Ordinary Course of Business, which the Company has obtained, used, stored, handled and disposed of in accordance with all Environmental Laws. Neither this Agreement nor the consummation of the transactions contemplated by this Agreement will result in any obligations for site investigation or cleanup, or notification to or consent of any governmental authority or third parties, pursuant to any so-called “transaction-triggered” or “responsible property transfer” Environmental Laws. Without limiting the foregoing, no facts, events or conditions relating to the past or present facilities, properties or operations of the Company will prevent, hinder or limit continued compliance with Environmental Laws, give rise to any investigatory, remedial or corrective obligations pursuant to Environmental Laws, or give rise to any other liabilities (whether accrued, absolute, contingent, unliquidated or otherwise, whether due or to become due, whether known or unknown, and regardless of whether asserted) pursuant to Environmental Laws, including any relating to onsite or offsite Releases or threatened Releases of Hazardous Materials, substances or wastes, personal injury, property damage or natural resource damage.

4.17 Employees. Section 4.17 of the Seller Disclosure Schedule correctly and completely lists (a) the names and annual or hourly rates of salary and other compensation of all the employees and agents of the Businesses, and (b) the outstanding balance of and method for calculating employee reserves and residuals. There are not any pending, or to the Knowledge of Seller or the Company, threatened against the Businesses general labor disputes, strikes or concerted work stoppages, and there are no discussions, negotiations, demands or proposals that are pending or have been conducted or made with or by any labor union or association with respect to any employees of the Businesses. Neither the Company nor Seller has Knowledge of the existence of any serious health condition of any key management personnel of the Businesses that might impair any such Person’s ability to carry on the essential functions of his or her position into the foreseeable future after the Closing. The relations between the Company, Seller and the employees of the Businesses are good. Neither the Company, Seller nor the Businesses have made any loans (except advances against accrued salaries or for business travel, lodging or other expenses in the Ordinary Course of Business) to any employee of the Businesses.

4.18 Employee Benefit Plans. Section 4.18 of the Seller Disclosure Schedule lists all plans, contracts, commitments, programs and policies (including pension, profit sharing, thrift, bonus, deferred compensation, severance, retirement, disability, medical, life, dental and accidental insurance, vacation, sick leave, death benefit and other similar employee benefit plans and policies) providing benefits to any employee or former employee of the Businesses (collectively, the “Plans”). Seller has delivered to Buyer true and correct copies of all documents embodying the Plans. All obligations of the Company under the Plans have been fully paid or fully funded in accordance with applicable Law. No Plan constitutes a defined benefit plan or defined contribution plan within the meaning of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).

4.19 Title to and Status of Purchased Assets. All of the property, rights and assets, real and personal or mixed, tangible and intangible, necessary for the operation of the Businesses, including the Real Property, Intellectual Property Rights and Tangible Personal Property, as and to the extent to which it is presently conducted and contemplated to be conducted by Buyer, are owned or validly leased by Businesses. The consummation of the transactions contemplated by

this Agreement will not impair Buyer's ability to so operate the Businesses, except for such impairment or impairments as would not have or reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect. The Company and/or Seller is in actual possession and control of all assets, rights and properties owned or leased by it that are required in the operation of the Businesses. Seller has good and marketable fee simple title to the Perris Home, the Lake Elsinore Home, and the Hemet Home, free and clear of all Encumbrances except for Permitted Encumbrances. Seller has a valid leasehold interest in the Sun City Home, free and clear of all Encumbrances except for Permitted Encumbrances. Seller and/or the Company have good and valid title to all other assets and rights of the Businesses, free and clear of all Encumbrances other than Permitted Encumbrances.

4.20 Real Property. Section 4.20 of the Seller Disclosure Schedule sets forth a legal description of all parcels of real property (collectively, the "*Real Property*"), and also briefly describes each building and major structure and improvement thereon that comprise the Facilities. No Person other than the Company or Seller has any interest in, or other right to occupy any portion of, the Real Property. The Real Property is the only interest in real property required for the conduct of the business of the Businesses as presently conducted. None of the buildings, structures and improvements located on the Real Property, or the operation or maintenance thereof as now operated or maintained, contravenes any zoning ordinance, set back, or Law, or Environmental Laws, the effect of which would interfere with or prevent their continued use for the purposes for which they are now being used. There is not pending nor, to the Knowledge of Seller or the Company, threatened any proceeding for the taking or condemnation of the Real Property or any portion thereof. All bills, taxes and other payments due with respect to the Company's or Seller's, as the case may be, operation and maintenance of the Real Property are paid, and no Encumbrances or other claims for the same have been filed or asserted against any part of the Real Property. The Real Property has physical and legal access to an open and publicly dedicated street. No portion of the Real Property is located within an area that has been designated by the Federal Insurance Administration, the Army Corp of Engineers, or any other governmental agency or body as being subject to special flooding hazards.

4.21 Tangible Personal Property. Section 4.21 of the Seller Disclosure Schedule lists all equipment, motor vehicles and other tangible personal property owned or leased by Seller and/or the Company and principally related to, or principally used in or necessary for the conduct of the Businesses, including all vehicles, office furniture, and operating and other supplies, tools, repair parts and spare parts located at the Businesses (collectively, "*Tangible Personal Property*").

4.22 Availability of Documents. Seller has delivered or made available to Buyer correct and complete copies of the items referred to in the Disclosure Schedule or in this Agreement (and in the case of any items not in written form, a written description thereof).

4.23 Finders. Neither Seller nor the Company is a party to or in any way obligated under any Contract or other agreement, and there are no outstanding Claims against it, for the payment of any broker's or finder's fee in connection with the origin, negotiation, execution or performance of this Agreement.

4.24 Full Disclosure. The representations and warranties made by Seller and the Company hereunder or in any Schedules or certificates furnished to Buyer pursuant hereto do not and will not contain any untrue statement of a fact or omit to state a fact required to be stated herein or therein or necessary to make the representations or warranties herein or therein, in light of the circumstances in which they are made.

ARTICLE V.

REPRESENTATIONS AND WARRANTIES OF BUYER

Buyer hereby represents and warrants to Seller and the Company as follows:

5.1 Incorporation; Power and Authority. Buyer is a corporation duly organized, validly existing and in good standing under the Laws of its jurisdiction of organization and has all necessary power and authority to execute, deliver and perform this Agreement and the Ancillary Agreements to which it will become a party, to carry out its obligations hereunder and thereunder and to consummate the transactions contemplated hereby and thereby.

5.2 Valid and Binding Agreement. The execution and delivery of this Agreement and the Ancillary Agreements by Buyer, the performance by Buyer of its obligations hereunder and thereunder and the consummation by Buyer of the transactions contemplated hereby and thereby have been duly authorized by all requisite action on the part of Buyer. This Agreement has been, and upon their execution, the Ancillary Agreements shall have been, duly executed and delivered by Buyer, and (assuming due authorization, execution and delivery by Seller and the Company) this Agreement constitutes, and upon their execution the Ancillary Agreements shall constitute, legal, valid and binding obligations of Buyer, enforceable against Buyer in accordance with their respective terms, subject to the Remedies Exception.

5.3 No Conflict and Consents. The execution, delivery and performance of this Agreement and the Ancillary Agreements to which it will become a party by Buyer will not:

(a) violate, conflict with or result in the breach of any provision of the Organizational Documents of Buyer;

(b) conflict with or violate any Law or Governmental Order applicable to Buyer;

(c) conflict with, result in any breach of any of the provisions of, constitute a default (or any event that would, with the passage of time or the giving of notice or both, constitute a default) under, result in a violation of, increase the burdens under, result in the termination, amendment, suspension, modification, abandonment or acceleration of payment (or any right to terminate) or require a Consent, including any Consent under any Contract or Governmental Authorization that is either binding upon or enforceable against Buyer; or

(d) require any Governmental Authorization.

5.4 Finders. Buyer is not a party to or in any way obligated under any Contract or other agreement, and there are no outstanding Claims against it, for the payment of any broker's

or finder's fee in connection with the origin, negotiation, execution or performance of this Agreement.

5.5 **Full Disclosure.** The representations and warranties made by Buyer hereunder or in any certificates furnished to Seller and the Company pursuant hereto do not and will not contain any untrue statement of a material fact or omit to state a material fact required to be stated herein or therein or necessary to make the representations or warranties herein or therein, in light of the circumstances in which they are made.

ARTICLE VI.

COVENANTS OF SELLER, THE COMPANY AND BUYER

6.1 **Conduct of the Business.** From the date of this Agreement to the Closing Date, (a) the Businesses shall be operated only in the Ordinary Course of Business and in accordance with applicable Law and (b) each of the Company and Seller shall use its best efforts to preserve the Goodwill of the Businesses, keep available the services of the employees and maintain satisfactory relationships with vendors, customers or others having business relationships with the Businesses. In particular, without the prior written consent of Buyer, Seller shall not, and shall cause the Company to not:

(i) (A) modify, amend, cancel or terminate any contract in respect of the Businesses to which Seller or any of its Affiliates is a party, other than in the Ordinary Course of Business, except that notwithstanding the foregoing in no event shall Seller or any of its Affiliates be permitted to modify, amend, cancel or terminate any of the Material Contracts or (B) enter into any Contract that would have been a Material Contract if such Contract had been in effect on the date of this Agreement, except that Seller or the Company may enter into Contracts with vendors or customers in the Ordinary Course of Business;

(ii) (A) sell, transfer or otherwise dispose of any Purchased Assets, other than inventory in the Ordinary Course of Business or (B) create, incur or assume any new Encumbrance, other than a Permitted Encumbrance, on the Purchased Assets;

(iii) (A) declare, set aside or pay any dividend or other distribution payable in cash, stock or property with respect to its capital stock or (B) redeem, purchase or otherwise acquire directly or indirectly any of its capital stock or other securities;

(iv) make any capital expenditure in excess of \$4,000 or make capital expenditures in the aggregate in excess of \$4,000; provided, however, that any capital expenditures in excess of \$4,000 or in the aggregate in excess of \$4,000 for structural improvements to the Facilities shall require the prior approval of Buyer;

(v) enter into any Contract or other commitment that, individually or in the aggregate, constitutes an Assumed Liability involving aggregate payments in excess of \$4,000 or that has a term of, or requires the performance of any obligations by Seller or any of its Affiliates over a period in excess of, one year, or incur any indebtedness for money borrowed that would constitute an Assumed Liability;

- (vi) change any of its methods of accounting other than changes required by GAAP;
- (vii) waive, cancel or compromise any material right or claim of Seller or any of its Affiliates in respect of the Purchased Assets or the Businesses;
- (viii) cancel or permit any insurance to lapse or terminate, unless renewed or replaced by like coverage;
- (ix) commit any act or permit the occurrence of any event or the existence of any condition of the type described in Section 4.6;
- (x) hire, fire, reassign or make any other change in key personnel of the Businesses, or increase the rate of compensation of or declare or pay any bonuses to any employee in excess of that listed on Section 4.18 of the Seller Disclosure Schedule;
- (xi) take any other action that would cause any of the representations and warranties made in Article IV hereof not to be true and correct in all material respects, on and as of the Closing Date, with the same force and effect as if the same had been made on and as of the Closing Date; and
- (xii) enter into any commitment to take any of the actions prohibited by any of the foregoing clauses.

6.2 Notice of Developments. Seller shall notify Buyer of any emergency or other change in the Ordinary Course of Business of the Businesses or the commencement or threat of Litigation. Seller shall promptly notify Buyer in writing if he or the Company should discover that any representation or warranty made by either him or the Company in this Agreement was made, or has subsequently become, untrue in any respect. No disclosure pursuant to this Section 6.2 will be deemed to amend or supplement the Seller Disclosure Schedule or to prevent or cure any inaccuracy, misrepresentation, breach of warranty or breach of agreement.

6.3 Access to Information.

(a) Upon reasonable advance notice, Seller and the Company shall afford the officers, employees, accountants, counsel and other representatives of Buyer, access, during normal business hours during the period prior to the Closing, to all of the properties, Real Property, books, Contracts, commitments, records, officers, employees, accountants and counsel and other representatives during such period. Seller and the Company shall make available to Buyer all information concerning each of the Businesses, properties and personnel as Buyer may reasonably request. Neither Seller nor the Company shall be required to provide access to or to disclose information where such access or disclosure would violate or prejudice the rights of its customers, jeopardize any attorney-client privilege or contravene any Law, rule, order, judgment, decree, fiduciary duty or binding agreement entered into prior to the date of this Agreement. The Parties will make appropriate substitute disclosure arrangements under circumstances in which the restrictions of the preceding sentence apply.

(b) After the Closing Date, each of Seller and the Company will afford to Buyer, its officers, employees, accountants, counsel and other representatives, during normal business hours, upon reasonable request, reasonable access to the books and records of Seller or the Company, as the case may be, pertaining to the Businesses to the extent that such access may be requested at no cost to Seller or the Company for a legitimate business purpose. Any information provided in accordance with terms of this Section 6.5 will be subject to the terms of a confidentiality agreement with terms substantially similar to terms of the confidentiality provisions in the Luyben Sr. Consulting Agreement.

6.4 No Shop. For so long as this Agreement remains in effect, neither Seller nor the Company shall, and shall not cause any other Person to, directly or indirectly, enter into any Contracts, or initiate, solicit or encourage any offers, proposals or expressions of interest, or otherwise hold any discussions with any potential buyers, investment bankers or finders, with respect to the possible sale or other disposition of all or any portion of the assets, rights and properties of the Businesses, the sale of all or a controlling interest in the stock of the Company, or the merger or consolidation of the Company, other than to or with Buyer. If Seller or the Company receives from any third party any inquiry regarding such a transaction, Seller shall promptly notify Buyer.

6.5 Employee Training; Systems Installation. To help prepare for and facilitate the transition of the Businesses to Buyer's ownership at and following the Closing, Buyer intends, prior to Closing, to begin providing certain training to select employees of the Businesses and to begin installation of certain of Buyer's management information systems. Seller agrees to, and agrees to cause the Company to, cooperate in Buyer's efforts in providing such training and installation. All training modules and all such systems shall remain the sole and exclusive property of Buyer, but Buyer's training and installation shall be at its sole cost, expense and risk. Neither Seller nor the Company shall be required to incur any out-of-pocket expenses in connection with such training and installation, and neither the Company nor Seller makes any representation or warranty whatsoever regarding the compatibility of each Business's system with those of Buyer. If this Agreement is terminated for any reason, Buyer will be entitled to remove, at its sole cost, expense and risk, all training modules and systems so provided or installed by it.

6.6 Non-Competition. If the Closing occurs, the Company agrees that it shall not, directly or indirectly, for a period commencing on the Closing Date and ending 10 years thereafter, do any of the following:

(a) engage, as principal, agent, trustee or through the agency of any entity, anywhere within a 50-mile radius of any of the Facilities (the "*Territory*"), in the funeral, mortuary, crematory, burial insurance, cemetery or any related line of business (the "*Restricted Business*");

(b) own or hold any beneficial interest in one percent or more of the voting securities in any entity which conducts its operations, in whole or in part, in the Restricted Business within the Territory;

(c) become an employee of or consultant to, or otherwise serve in any similar capacity with, any corporation, partnership or other business entity that conducts its business, in whole or in part, in the Restricted Business within the Territory;

(d) cause or induce any present or future employee of Buyer or any of its Affiliates to leave the employ of Buyer or any such Affiliate to accept employment with the Company or with any Person with which the Company may be or become affiliated; or

(e) make any public statements recommending the use of any competitor of Buyer or criticizing Buyer or its business, operations, practices or policies, or otherwise knowingly or intentionally do or say any act or thing which will or may impair, damage or destroy the goodwill of Buyer within the Territory.

(f) Without limiting the generality of the foregoing, the Company shall be deemed directly or indirectly engaged in the Restricted Business if the Company:

(i) acts as a funeral director for any funeral establishment within the Territory;

(ii) engages in the sale or marketing of preneed contracts for services to be performed or merchandise to be sold within the Territory;

(iii) promotes or finances (by loan, guaranty or otherwise) any family member or Affiliate to operate a Restricted Business or engage in any of the foregoing activities within the Territory;

(iv) direct or indirect use or disclosure of Protected Information (as defined in the Luyben Sr. Consulting Agreement) related to the Restricted Business; or

(v) lends or licenses its name or likeness to any Restricted Business within the Territory, with or without compensation.

(g) Reformation. The above covenants shall not be held invalid or unenforceable because of the scope of the Territory or actions subject thereto or restricted thereby, or the period of time within which such covenants are operative; but any judgment of a court of competent jurisdiction may define the maximum territory and actions subject to and restricted thereby and the period of time during which such covenants are enforceable.

(h) Remedies. Each of the Company, Seller and Buyer agree that Buyer shall have all available legal and equitable remedies and rights, and the specific inclusion of any remedy in this Agreement shall not constitute a whole or partial election or waiver of any other available remedy or right. The Company agrees that a violation of the terms, provisions, covered obligations, duties and conditions described in this Section 6.6 will give rise to Buyer's or its Affiliate's causes of action (including breach of the Employment Agreement) against Seller and the Company for, among other relief, issuance of injunctive relief, issuance of a temporary restraining order, specific performance, recovery of damages, and recovery of Buyer's costs, attorney's fees, and expert witness fees. The Company further agrees that it is difficult to calculate the amount and extent of any damages caused by such a violation and such a violation

threatens to injure or actually does injure Buyer and the Businesses. The Company agrees that Buyer shall have the non-exclusive right to apply for and to receive a temporary restraining order, a temporary or preliminary and a permanent injunction to enforce the terms, provisions, covenants, obligations, duties and conditions described in this Section 6.6. The Company further agrees that Buyer, in applying for or receiving any restraining order or injunctive relief, need only post, and shall only be required to post, a bond of not more than \$1,000.00. In addition, the ten-year term of this Section 6.6 shall be extended by the period of time during which the Company is in material breach hereof as determined by a court of competent jurisdiction.

(i) Representations. Each of Seller and the Company represents and warrants to and agrees with Buyer that (i) it understands that the foregoing restrictions are being made incident to and as a condition of the purchase and sale of the Purchased Assets hereunder, and that such covenants are necessary in order to protect the Businesses and Goodwill being acquired thereby; (ii) such covenants are not oppressive to the Company in any respect; and (iii) the consideration for such restrictions is included in the Purchase Price, which consideration each of the Company and Seller acknowledges is fair and adequate for the giving of the covenants herein and for which each of the Company and Seller acknowledges a direct and valuable benefit.

(j) Purchase Price Allocation. The Parties agree to allocate \$50,000.00 of the Purchase Price paid to the Company to certain of the covenants of the Company set forth in Section 6.6. Such allocation is not intended to be a measure of the amount or range of damages that Buyer may suffer or recover as a result of any breach of the foregoing covenants, and each of Seller and the Company acknowledges that in case of any such breach, Buyer shall be entitled to seek in excess of such amount as it may otherwise be able to demonstrate itself justly entitled to.

6.7 Employee Matters. On the Closing Date, Buyer may (but shall not be required to) offer employment to each employee of the Businesses listed on Schedule 4.18. Each such employee so offered employment who accepts shall, effective as of the Closing Date, cease to be an employee of the Company and shall thereupon become an employee of Buyer. The Company shall be responsible for satisfying all claims, if any, of such employees as to health benefits, workers compensation claims, termination and severance benefits, and any withdrawal liability and vested rights under any pension or profit sharing plans, all arising and accrued through the Closing Date, and in no event shall Buyer have any liability or responsibility in respect thereof.

6.8 Further Assurances. Each of Seller and the Company shall from time to time after the Closing, without further consideration, execute and deliver such instruments and documents, and shall take such other action as Buyer may reasonably request to more effectively carry out the provisions of this Agreement.

6.9 Post-Closing Access. After the Closing Date, Buyer will afford to Seller and Seller's accountants, counsel and other representatives, during normal business hours, upon reasonable request, reasonable access to the books and records of Buyer pertaining to the Businesses to the extent that such access may be requested at no cost to Buyer for a legitimate business purpose. Any information provided in accordance with terms of this Section 6.9 will be subject to the terms of a confidentiality agreement with terms substantially similar to the confidentiality provisions set forth in the Luyben Sr. Consulting Agreement.

6.10 Buyer's Trustee and Preneed Trust Funds. Prior to the Closing, to the extent permitted by applicable Law, Seller shall have directed all trustees of the trust accounts set forth on Section 4.11 of the Seller Disclosure Schedule to liquidate any and all marketable securities and other assets, and to retain trust assets in cash and cash equivalents only.

6.11 Unique Preneed Merchandise. If any preneed Contracts call for the delivery of products not available to Buyer because of exclusivity arrangements with the Company or its Affiliates, the Company will make arrangements with Buyer to enable Buyer to purchase that merchandise, either from the Company or directly from the Company's vendor, to enable Buyer to fulfill those preneed Contracts, at prevailing commercial prices and terms.

6.12 Litigation. During the period from the date of this Agreement to the Closing, each of the Company, Seller and Buyer shall promptly notify the other upon learning of any claims or actions threatened or commenced against such party or any of its Affiliates (including any Claims filed against any parcel of Real Property) that would have a material adverse effect on the ability of such Party or any of their respective Affiliates (as the case may be) to consummate the transactions contemplated by this Agreement.

ARTICLE VII. OTHER COVENANTS

7.1 Efforts.

(a) Without prejudice to Section 7.2, each of the Parties agrees to use its reasonable commercial efforts to take, or cause to be taken, all actions and to do, or cause to be done, all things necessary, proper or advisable to consummate and make effective as promptly as practicable the transactions contemplated hereby and to cooperate with the other Party in connection with the foregoing, including using its commercially reasonable efforts (i) to obtain all necessary waivers, consents and approvals from other parties to the Contracts; (ii) to obtain all Consents that are required to be obtained under any applicable Law; (iii) to lift or rescind any injunction or restraining order or other order adversely affecting the ability of the Parties to consummate the transactions contemplated by this Agreement; (iv) to effect all registrations and filings, if any, necessary to consummate the transactions contemplated hereby; and (v) to fulfill all conditions to the Closing (including those conditions set forth in Article VIII).

(b) Anything in this Agreement to the contrary notwithstanding, this Agreement shall not constitute an agreement to assign any Contract or Governmental Authorization that would otherwise be a Purchased Asset (the "*Assigned Contracts*") if an attempted assignment thereof, without the Consent of another party thereto or any Governmental Entity, would constitute a breach of any such Assigned Contracts or in any way violate any applicable Law or other legal requirement of any Governmental Entity, and such Consent is not obtained prior to the Closing.

(c) If, with respect to an Assigned Contract, such Consents are not obtained, or if an attempted assignment would be ineffective, the beneficial interest in and to such Assigned Contracts shall in any event pass to Buyer at the Closing, and each of Seller and the

Company shall use commercially reasonable efforts to provide to Buyer all of Seller's or the Company's, as the case may be, entire interest in the benefits under any such Assigned Contract. Each of Seller and the Company shall exercise or exploit its rights and options under any such Assigned Contract (including the right to elect to terminate such Assigned Contract in accordance with the terms thereof) only as directed by Buyer. If Buyer receives an economic benefit under any such Assigned Contract, Buyer shall accept the burdens and perform the obligations under such Assigned Contract as subcontractor of Seller or the Company, as the case may be, to the extent of the benefit received, and to the extent such burdens and obligations would have constituted an Assumed Liability if such Assigned Contract had been transferred to Buyer at the Closing. Furthermore, if the other party(ies) to such an Assigned Contract subsequently consent to the assignment of such contract to Buyer, Buyer shall thereupon agree to assume and perform all liabilities and the obligations arising thereunder after the date of such consent, at which time such Assigned Contract shall be deemed a Purchased Asset, without the payment of further consideration, and the obligations so assumed thereunder shall be deemed Assumed Liabilities.

(d) The Parties further covenant and agree, with respect to any threatened or pending preliminary or permanent injunction or other order, decree or ruling or statute, rule, regulation or executive order that would adversely affect the ability of the Parties to consummate the transactions contemplated by this Agreement, to use commercially reasonable efforts to prevent the entry, enactment or promulgation thereof, as the case may be; provided, however, that the foregoing shall not be deemed to require the parties to accept or agree to any requirement to divest or hold separate or in trust (or the imposition of any other condition or restriction with respect to) any assets or operations of such Party or the Businesses.

7.2 Further Assurances.

(a) Each of the Parties agrees to execute and deliver such instruments, and take such other actions, as may reasonably be required whether prior to, at or following the Closing, to (i) carry out the terms of this Agreement and the other documents contemplated hereby and (ii) consummate the transactions contemplated by this Agreement and the other documents contemplated by this Agreement.

(b) In the event that, following the Closing, the Parties discover that one or more of the Purchased Assets or Assumed Liabilities was not transferred to, or assumed by, as the case may be, Buyer hereunder, each of the Company, Buyer and Seller agree to use their commercially reasonable efforts to cause such Purchased Assets to be transferred to Buyer or Assumed Liability to be assumed by Buyer, as the case may be, pursuant to the terms of this Agreement.

(c) Tax Parcel ID. Each of the Parties agrees to execute and deliver such instruments, and to take such other actions, as may reasonably be required, to cause the proper Governmental Entity to provide a new tax parcel identification number for each of Lot 1 and Lot 2 on the Perris Home, which lots are currently both identified under the current tax parcel identification number 313-132-043.

ARTICLE VIII.

CONDITIONS TO CLOSING

8.1 Conditions to Obligation of Each Party to Close . The respective obligations of each Party to effect the transactions contemplated hereby shall be subject to the satisfaction or waiver at or prior to the Closing Date of the following conditions:

- (a) no preliminary or permanent injunction or other Governmental Order shall have become effective restraining, enjoining or otherwise prohibiting or making illegal the consummation of any of the transactions contemplated hereby;
- (b) all Consents of other Persons and Governmental Entities to the transactions contemplated by this Agreement shall have been obtained;
- (c) a termination of the Sun City Lease shall have been delivered in accordance with the provisions of Article III; and
- (d) the New Sun City Ground Lease shall have been delivered in accordance with the provisions of Article III.

8.2 Conditions to Buyer's Obligation to Close . Buyer's obligation to effect the transactions contemplated by this Agreement shall be subject to the satisfaction or waiver on or prior to the Closing Date of all of the following conditions (it being understood and agreed that no such waiver of any condition set forth herein shall constitute a waiver of any rights or remedies that Buyer may have under this Agreement with respect to the facts and circumstances giving rise to the failure of such condition to be satisfied):

(a) Representations and Warranties True. (i) The representations and warranties of Seller and the Company set forth in Section 4.19 shall be true and correct as of the date of this Agreement and (except to the extent such representations and warranties speak as of an earlier date) as of the Closing Date as though made on and as of the Closing Date; and (ii) the representations and warranties of Seller and the Company set forth in this Agreement (other than the representations and warranties set forth in Section 4.19 of this Agreement) shall be true and correct in all material respects as of the date of this Agreement and (except to the extent such representations and warranties speak as of an earlier date) as of the Closing Date as though made on and as of the Closing Date; provided, however, that for purposes of determining the satisfaction of the condition contained in this clause (ii), no effect shall be given to any exception in such representations and warranties relating to materiality or a Material Adverse Effect; and provided further, however, that, for purposes of this clause (ii), such representations and warranties shall be deemed to be true and correct in all material respects unless the failure or failures of such representations and warranties to be so true and correct, individually or in the aggregate, represent or would reasonably be expected to represent a Material Adverse Effect.

(b) Covenants. The covenants and agreements of each of Seller and the Company to be performed on or prior to the Closing Date in accordance with this Agreement shall have been duly performed in all material respects.

(c) Certificate of Officer. Buyer shall have received a certificate dated the Closing Date and duly executed by Seller, certifying as to the satisfaction of the conditions set forth in Sections 8.2(a) and 8.2(b) herein.

(d) No Loss or Damage. After the date of this Agreement, there shall not have occurred a Material Adverse Effect. In the event of any Loss to any substantial portion of the assets, rights or properties of Seller or the Company, Seller shall promptly inform Buyer, and each of the Company and Seller shall be allowed a reasonable time thereafter (not to exceed 60 days after the Outside Closing Date) within which to repair or replace such Loss. Neither the Company nor Seller, however, shall be under any obligation to repair or replace such Loss. In the event neither the Company nor Seller promptly begins such repair or replacement or does not complete such repair or replacement within said 60-day period, Buyer may (in its sole discretion) either (i) complete the sale contemplated by this Agreement (with such assets or property in their damaged condition) and receive an assignment of the Company's or Seller's insurance claim or claims, as the case may be, relating to such loss or damage, or (ii) terminate this Agreement without any obligation to pay any amounts to Seller or the Company

(e) Approval by Counsel. All actions, proceedings, instruments and documents required to carry out the transactions contemplated by this Agreement or incidental thereto, and all other related legal matters shall have been approved by counsel for Buyer, and such counsel shall have been furnished with such certified copies of actions and proceedings and other instruments and documents as they shall have been reasonably requested.

(f) Pre-Acquisition Review. Buyer and its representatives shall have completed a pre-acquisition review of the financial information, books and records, and properties and assets of the Businesses (including the Real Property) and shall have discovered no change in the Business, assets, operations, financial condition or prospects of the Businesses that could, in the sole determination of Buyer, have Material Adverse Effect.

(g) Environmental, OSHA and Structural Reports. There shall have been conducted, at Buyer's expense, (i) a Phase I (and, if deemed necessary by Buyer, a Phase II) environmental inspection of the Businesses and the Real Property by an environmental consulting firm selected by Buyer, (ii) a health and safety inspection of the Businesses by a Person (who may be an employee of Buyer) or firm selected by Buyer and who is qualified and experienced in such matters in the funeral industry, and (iii) a structural inspection of the Businesses by an engineering firm selected by Buyer. If any remedial or corrective actions are recommended as a result of such inspections, then the cost thereof in an amount not to exceed \$25,000 in the aggregate shall be deducted from the Purchase Price; if the cost of such actions exceeds \$25,000, then Buyer may (in its sole discretion) either (x) proceed with Closing and deduct \$25,000 from the Purchase Price, or (y) terminate this Agreement without any obligation to pay any amounts to Seller or the Company. In any event, it shall be a condition to Buyer's obligations under this Agreement that the results of the reports of such firms or Persons shall be satisfactory to Buyer in its sole discretion.

(h) Title Insurance. Buyer shall have received a current owner's policy of title insurance issued to Buyer insuring its fee simple ownership interest (or valid leasehold interest with respect to the Sun City Home with adequate legal access) in each parcel of Real

Property. Such policies shall have been issued in an agreed-upon amount by Chicago Title Insurance Company or another title company reasonably acceptable to the parties (the "*Title Company*") and shall be subject only to Permitted Encumbrances; provided, however, that such policy shall have deleted any exceptions regarding restrictions or be limited to restrictions that are Permitted Encumbrances, any standard exceptions pertaining to discrepancies, conflicts or shortages in area shall be deleted except for "shortages in area", and any standard exceptions for taxes shall be limited to subsequent years.

(i) Survey. Buyer shall have received an ALTA/ACSM survey prepared by a licensed surveyor approved by Buyer and acceptable to the Title Company, with respect to each parcel of the Real Property and the Sun City Home, which survey shall comply with any applicable standards under California law, be properly certified to Buyer and its successors and/or assigns and the Title Company, be sufficient for Title Company to delete any survey exception contained in the owner's policy of title insurance referred to in Section 8.2(h), and otherwise be in form and content acceptable to Buyer.

(j) Lien Releases. The holders of any Encumbrances against any of the assets, rights and properties of the Businesses and/or Real Property shall have executed and delivered written releases of such Encumbrances, all in recordable form and otherwise acceptable to Buyer or the Title Company.

(k) Other Management Arrangements. Seller shall have identified to Buyer such personnel of the Businesses as may be key to the continued effective management and operation of the Businesses after the Closing, and Buyer shall have entered into mutually satisfactory arrangements regarding the continued employment of such personnel at the Businesses following the Closing.

(l) Closing Deliveries. Buyer shall have received the documents referred to in Section 3.5.

8.3 Conditions to the Company's or Seller's Obligation to Close. Each of Seller's and the Company's obligation to effect the transactions contemplated by this Agreement shall be subject to the satisfaction or waiver on or prior to the Closing Date of all of the following conditions (it being understood and agreed that no such waiver of any condition set forth herein shall constitute a waiver of any rights or remedies that Buyer may have under this Agreement with respect to the facts and circumstances giving rise to the failure of such condition to be satisfied):

(a) Representations and Warranties True. Each of the representations and warranties of Buyer contained in this Agreement shall be true and correct, as of the Closing Date (except to the extent such representation and warranty speaks as of an earlier date), as though made on and as of the Closing Date, except where the failure to be so true and correct would not, individually or in the aggregate, have or be reasonably likely to have a material adverse effect on Buyer's ability to effect the transactions contemplated herein.

(b) Covenants. The covenants and agreements of Buyer to be performed on or prior to the Closing Date in accordance with this Agreement shall have been duly performed in all material respects.

(c) Certificate of Officer. Seller and the Company shall have received a certificate dated the Closing Date and executed on behalf of Buyer, certifying as to the matters specified in Sections 8.3(a) and 8.3(b).

(d) Closing Deliveries. Each of Seller and the Company shall have received the payment and the documents referred to in Section 3.5(a)(i).

(e) Approval by Counsel. All actions, proceedings, instruments and documents required to carry out the transactions contemplated by this Agreement or incidental thereto and all other related legal matters shall have been approved by counsel for Seller, and such counsel shall have been furnished with such certified copies of actions and proceedings and other instruments and documents as they shall have reasonably requested.

ARTICLE IX.

TERMINATION

9.1 Termination. This Agreement may be terminated prior to the Closing Date only, and then only by any of the following:

(a) by written agreement of Seller and Buyer;

(b) at the election of Buyer if any condition set forth in Sections 8.1 and 8.2 (other than Sections 8.2(d) and 8.2(g)) becomes incapable of fulfillment and is not waived by Buyer, unless the failure of the Closing to occur shall be due to the failure of Buyer to perform or observe the covenants and agreements of Buyer set forth herein; provided, however, that any such condition relating to a breach or a failure to perform a representation, warranty, covenant or other agreement prior to the Closing Date shall be a cause for termination of this Agreement only if such breach or failure cannot be or has not been cured within 30 days after the giving of written notice of such breach or failure to Seller, such notice to be given promptly after Buyer becomes aware of such breach or failure;

(c) at the election of Seller if any condition set forth in Sections 8.1 and 8.3 becomes incapable of fulfillment and is not waived by Seller, unless the failure of the Closing to occur shall be due to the failure of Seller to perform or observe the covenants and agreements of Seller set forth herein; provided, however, that any such condition relating to a breach or a failure to perform a representation, warranty, covenant or other agreement prior to the Closing Date shall be a cause for termination of this Agreement only if such breach or failure cannot be or has not been cured within 30 days after the giving of written notice of such breach or failure to Buyer, such notice to be given promptly after Seller becomes aware of such breach or failure;

(d) under the circumstances described in Section 8.2(d) or 8.2(g); or

(e) at the election of Seller or Buyer, if the Closing shall have not occurred by the earlier of November 15, 2007 (the “*Outside Closing Date*”) (other than as a result of a breach of this Agreement by the Party seeking termination).

9.2 Effect of Termination. Upon termination of this Agreement pursuant to Section 9.1, no Party, or its shareholders, directors, officers and employees shall thereafter have any further liability or obligation hereunder; provided, however, that such termination shall not relieve (a) any Party of any liability for any breach of this Agreement prior to the date of such termination; and (b) the obligations of the Parties set forth in Sections 11.1, 11.2, 11.11 and 11.13 and such Sections 11.1, 11.2, 11.11 and 11.13 shall not be affected by a termination or abandonment of this Agreement.

ARTICLE X. INDEMNIFICATION

10.1 Indemnification by the Company and Seller.

(a) General. Subject to the express provisions of this Article X, the Company and Seller jointly and severally shall indemnify, defend and hold harmless Buyer, its Affiliates and the respective officers, directors, employees and agents of Buyer and its Affiliates (collectively, the “*Buyer Indemnified Parties*”) from and against all Losses incurred or suffered by a Buyer Indemnified Party, arising from or related to:

(i) any inaccuracy or breach of any representation or warranty made by Seller or the Company in this Agreement, any Schedule to this Agreement or any Ancillary Agreement;

(ii) any breach by Seller or the Company of any of its covenants, obligations or agreements contained in this Agreement; and

(iii) any Excluded Liability.

(b) Certain Limitations.

(i) Notwithstanding anything herein to the contrary, for purposes of this Section 10.1, (A) a breach of a representation or warranty shall be deemed to exist either if such representation or warranty is actually inaccurate or breached or would have been inaccurate or breached if such representation or warranty had not contained any limitation or qualification as to materiality, Material Adverse Effect or similar language, and (B) the amount of Losses in respect of any breach of a representation or warranty, including any deemed breach resulting from the application of clause (A), shall be determined as if such representation and warranty had not contained any limitation or qualification as to materiality, Material Adverse Effect or similar language set forth in such representation or warranty.

(ii) The representations and warranties of Seller and the Company contained in this Agreement shall survive the Closing until the first anniversary of the Closing Date; provided, however, that (A) the representations and warranties made pursuant to Sections

4.1, 4.2, 4.3, 4.19, 4.20 and 4.23 shall survive indefinitely and (B) the representations and warranties made pursuant to Section 4.8 shall survive until 60 days after the expiration of the relevant statute of limitations, including any extension thereof, for the assessment or collection of any Tax. Neither the period of survival nor the liability of Seller with respect to Seller's representations and warranties shall be reduced by any investigation made at any time by or on behalf of Buyer. If written notice of a claim, which sets forth the facts that Buyer believes, in good faith, constitute a reasonable basis for indemnification, has been given prior to the expiration of the applicable representations and warranties by Buyer to Seller or the Company, then the relevant representations and warranties shall survive as to such claim, until such claim has been finally resolved.

(iii) No indemnification pursuant to Section 10.1(a)(i) shall be required with respect to any individual Loss of Buyer, unless the aggregate of all Losses of Buyer described in Section 10.1(a)(i) with respect to of this Agreement shall exceed \$25,000.00, in which case Seller shall be liable only for the Losses in excess of \$25,000.00.

(iv) Except in the case of actual fraud, the maximum aggregate amount of Losses against which Buyer shall be entitled to be indemnified under (A) Section 10.1(a)(i) with respect to all claims thereunder (other than with respect to claims for breach of a representation or warranty (x) that pursuant to Section 10.1(b)(ii) survive the Closing indefinitely and (y) in Section 4.8) shall be equal to 10% of the Purchase Price and (B) Section 10.1(a)(i) with respect to all claims for breaches of representation and warranty (x) that pursuant to Section 10.1(b)(ii) survive the Closing indefinitely and (y) in Section 4.8, shall be equal to the Purchase Price.

(v) For purposes of this Article X, all Losses shall be computed net of any insurance coverage with respect thereto; provided, however, that, in all cases, the timing of the receipt or realization of insurance proceeds shall be taken into account in determining the amount of reduction of Losses. If the Indemnified Party elects to do so, the costs and expenses (including reasonable fees and disbursements of counsel) reasonably incurred by the Indemnified Parties in pursuing any insurance proceeds or indemnity, contribution or other similar payment from any insurer shall reduce the total amount of insurance coverage received in connection with such Losses, except to the extent such costs and expenses are paid or reimbursed by such insurer or other third party.

10.2 Indemnification by Buyer. Subject to the express provisions of this Article X, Buyer shall indemnify and hold harmless Seller, the Company and their respective Affiliates, and the respective officers, directors, employees and agents of Seller, the Company and their respective Affiliates (collectively, the "Seller Indemnified Parties") from and against all Losses incurred or suffered by a Seller Indemnified Party arising from or related to:

(a) any inaccuracy or breach of any representation or warranty made by Buyer in this Agreement, any Schedule to this Agreement or any Ancillary Agreement;

(b) any breach by Buyer of any of its covenants, obligations and agreements contained in this Agreement; and

(c) any Assumed Liabilities.

10.3 Procedures for Indemnification. The Buyer Indemnified Parties or Seller Indemnified Parties, as the case may be, making a claim for indemnification under Section 10.1 or Section 10.2 shall be, for the purposes of this Agreement, referred to as the "*Indemnified Party*" and the Party or Parties against whom such claims are asserted under this Article X shall be, for the purposes of this Agreement, referred to as the "*Indemnifying Party*." All claims by any Indemnified Party under this Article X shall be asserted and resolved as follows:

(a) Notice. In the event that (i) any Claim is asserted or instituted by any person other than Buyer, the Company or Seller or their respective Affiliates that could give rise to Losses for which an Indemnifying Party could be liable to an Indemnified Party under this Agreement (such claim, demand or proceeding, a "*Third Party Claim*") or (ii) any Indemnified Party under this Agreement shall have a claim to be indemnified by any Indemnifying Party under this Agreement that does not involve a Third Party Claim (such claim, a "*Direct Claim*"), the Indemnified Party shall promptly send to the Indemnifying Party a written notice specifying the nature of such claim, demand or proceeding and the amount or estimated amount thereof if known (which amount or estimated amount shall not be conclusive of the final amount, if any, of such claim, demand or proceeding) (a "*Claim Notice*"); provided, however, that the failure to provide such notice shall not release the Indemnifying Party from any of its obligations under this Article X except to the extent that the Indemnifying Party is materially prejudiced by such failure. In the event of a Direct Claim, the Indemnifying Party shall notify the Indemnified Party within 60 Business Days of receipt of a Claim Notice whether or not the Indemnifying Party disputes such claim.

(b) Right to Contest Third Party Claims. In the event of a Third Party Claim, if the Indemnifying Party acknowledges in writing its obligations to indemnify the Indemnified Party hereunder against any Losses that may result from such Third Party Claim, the Indemnifying Party shall be entitled to appoint counsel of the Indemnifying Party's choice at the expense of the Indemnifying Party to represent the Indemnified Party and any others the Indemnifying Party may reasonably designate in connection with such claim, demand or proceeding (in which case the Indemnifying Party shall not thereafter be responsible for the fees and expenses of any separate counsel retained by any Indemnified Party except as set forth below). Notwithstanding an Indemnifying Party's election to appoint counsel to represent an Indemnified Party in connection with a Third Party Claim, an Indemnified Party shall have the right to employ separate counsel, and the Indemnifying Party shall bear the reasonable fees, costs and expenses of such separate counsel if (i) the Indemnified Party reasonably believes that there exists a conflict of interest that, under applicable principles of legal ethics, could prohibit a single legal counsel from representing both the Indemnified Party and the Indemnifying Party in such claim, demand or proceeding or (ii) the Indemnifying Party has failed or is failing to prosecute or defend vigorously such claim, demand or proceeding. If requested by the Indemnifying Party, the Indemnified Party agrees to cooperate with the Indemnifying Party and its counsel in contesting any claim, demand or proceeding which the Indemnifying Party defends, or, if appropriate and related to the claim, demand or proceeding in question, in making any counterclaim against the Person asserting the Third Party Claim, or any cross-complaint against any Person.

(c) Settlement. No Third Party Claim may be settled or compromised (i) by the Indemnified Party without the prior written consent of the Indemnifying Party, which consent shall not be unreasonably conditioned, withheld or delayed, or (ii) by the Indemnifying Party without the prior written consent of the Indemnified Party, which consent shall not be unreasonably conditioned, withheld or delayed; provided that if the Indemnifying Party submits to the Indemnified Party a bona fide settlement offer from a third party claimant of any Third Party Claim (which settlement offer will include as an unconditional term of it the full and unconditional release by the claimant or the plaintiff to the Indemnified Party from all liability in respect of such claim) and the Indemnified Party refuses to consent to such settlement, then thereafter the Indemnifying Party's liability to the Indemnified Party with respect to such Third Party Claim will not exceed the settlement amount included in such bona fide settlement offer, and the Indemnified Party will either assume control and responsibility for the payment of the defense of such Third Party Claim or pay the attorneys' fees and other out-of-pocket costs and expenses incurred by the Indemnifying Party thereafter in continuing the defense of such Third Party Claim. In the event any Indemnified Party settles or compromises or consents to the entry of any judgment with respect to any Third Party Claim without the prior written consent of the Indemnifying Party, such Indemnified Party shall be deemed to have waived all rights against the Indemnifying Party for indemnification under this Article X with respect to such Third Party Claim.

ARTICLE XI.

GENERAL

11.1 Press Releases and Announcements. Any public announcement, including any announcement to employees, customers or suppliers and others having dealings with the Businesses, or similar publicity with respect to this Agreement or the transactions contemplated by this Agreement, will be issued, if at all, at such time and in such manner as Buyer determines and approves. Buyer will have the right to be present for any in-person announcement. Unless consented to by Buyer or required by Law, each of the Company and Seller shall keep this Agreement and the transactions contemplated by this Agreement confidential.

11.2 Expenses. Except as otherwise expressly provided for in this Agreement, the Company and Seller, on the one hand, and Buyer, on the other hand, will each pay all expenses incurred by each of them in connection with the transactions contemplated by this Agreement, including legal, accounting, investment banking and consulting fees and expenses incurred in negotiating, executing and delivering this Agreement and the other agreements, exhibits, documents and instruments contemplated by this Agreement (whether the transactions contemplated by this Agreement are consummated or not).

11.3 Amendment and Waiver. This Agreement may not be amended, nor may any provision of this Agreement or any default, misrepresentation, or breach of warranty or agreement under this Agreement be waived, except in writing executed by the party against which such amendment or waiver is sought to be enforced. Neither the failure nor any delay by any Person in exercising any right, power or privilege under this Agreement will operate as a waiver of such right, power or privilege, and no single or partial exercise of any such right, power or privilege will preclude any other or further exercise of such right, power or privilege or

the exercise of any other right, power or privilege. In addition, no course of dealing between or among any Persons having any interest in this Agreement will be deemed effective to modify or amend any part of this Agreement or any rights or obligations of any Person under or by reason of this Agreement. The rights and remedies of the parties to this Agreement are cumulative and not alternative.

11.4 Notices. All notices, demands and other communications to be given or delivered under or by reason of the provisions of this Agreement will be in writing and will be deemed to have been given (a) when delivered, if personally delivered by hand (with written confirmation of receipt), (b) when received, if sent by a nationally recognized overnight courier service (receipt requested), (c) five Business Days after being mailed, if sent by first class mail, return receipt requested, or (d) when receipt is acknowledged by an affirmative act of the Party receiving notice, if sent by facsimile, telecopy or other electronic transmission device (provided that such an acknowledgement does not include an acknowledgment generated automatically by a facsimile or telecopy machine or other electronic transmission device). Notices, demands and communications to Buyer, the Company and Seller will, unless another address is specified in writing, be sent to the address indicated below:

If to Buyer:

Carriage Funeral Services of California, Inc.
3040 Post Oak Blvd., Suite 300
Houston, Texas 77056
Attention: VP of Corporate Development
Facsimile No. (713) 332-8401

With a copy to:

Greenberg Traurig, LLP
1000 Louisiana, Suite 1800
Houston, TX 77002
Attn: William Sultemeier
Facsimile No: (713) 374-3505

If to Seller and the Company:

27010 Encanto Drive
Sun City, California 92585
Attn: Thaddeus M. Luyben, Sr.
Facsimile No.: (949) 476-9320

With a copy to:

Stephens & Kray
5000 Birch Street, Suite 400
Newport Beach, CA 92660
Attn: Lon T. Stephens
Facsimile No.: (949) 476-9320

11.5 Assignment. Neither this Agreement nor any of the rights, interests or obligations hereunder may be assigned by any Party without the prior written consent of the other Parties to this Agreement, except that Buyer may assign any of its rights under this Agreement to any of its Affiliates. Subject to the foregoing, this Agreement and all of the provisions of this Agreement will be binding upon and inure to the benefit of the Parties to this Agreement and their respective successors and permitted assigns.

11.6 No Third Party Beneficiaries. Nothing expressed or referred to in this Agreement confers any rights or remedies upon any Person that is not a Party or permitted assign of a Party.

11.7 Severability. Whenever possible, each provision of this Agreement will be interpreted in such manner as to be effective and valid under applicable Law, but if any provision of this Agreement is held to be prohibited by or invalid under applicable Law, such provision will be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement.

11.8 Complete Agreement. This Agreement and when executed and delivered the Ancillary Agreements, the Luyben Sr. Consulting Agreement and the Luyben Sr. Assignment Agreement, contain the complete agreement between the Parties and supersede any prior understandings, agreements or representations by or between the Parties, written or oral.

11.9 Schedules. The Seller Disclosure Schedule contains a series of schedules corresponding to the sections contained in Article IV. The schedules in the Seller Disclosure Schedule relate only to the representations and warranties in the section and subsection of this Agreement to which they correspond and not to any other representation or warranty in this Agreement. In the event of any inconsistency between the statements in this Agreement and statements in the Seller Disclosure Schedule, the statements in this Agreement will control and the statements in the Seller Disclosure Schedule will be disregarded.

11.10 Signatures; Counterparts. This Agreement may be executed in one or more counterparts, any one of which need not contain the signatures of more than one Party, but all such counterparts taken together will constitute one and the same instrument. A facsimile signature will be considered an original signature.

11.11 GOVERNING LAW. THE DOMESTIC LAW, WITHOUT REGARD TO CONFLICTS OF LAWS AND PRINCIPLES, OF THE STATE OF CALIFORNIA WILL GOVERN ALL QUESTIONS CONCERNING THE CONSTRUCTION, VALIDITY AND INTERPRETATION OF THIS AGREEMENT AND THE PERFORMANCE OF THE OBLIGATIONS IMPOSED BY THIS AGREEMENT.

11.12 Specific Performance. Each of the Parties acknowledges and agrees that the subject matter of this Agreement, including the assets and properties of the Businesses and the Real Property, is unique, that the other Party would be damaged irreparably in the event any of the provisions of this Agreement are not performed in accordance with their specific terms or otherwise are breached, and that the remedies at Law would not be adequate to compensate such other Parties not in default or in breach. Accordingly, each of the Parties agrees that the other Party will be entitled to an injunction or injunctions to prevent breaches of the provisions of this Agreement and to enforce specifically this Agreement and the terms and provisions of this Agreement in addition to any other remedy to which they may be entitled, at Law or in equity. The Parties waive any defense that a remedy at Law is adequate and any requirement to post bond or provide similar security in connection with actions instituted for injunctive relief or specific performance of this Agreement.

11.13 Dispute Resolution.

(a) Every controversy, Claim, or dispute arising from or relating to this Agreement (“*Dispute*”) shall be resolved in accordance with this Section 11.13. The Parties will attempt in good faith to resolve promptly any Dispute by negotiations between Seller and an officer of Buyer. If the Parties so agree, such individuals may be assisted by a mediator supplied by the American Arbitration Association (“AAA”), and the costs and fees of the mediation will be borne equally by the Parties. If the Dispute is not resolved within 30 days of a Party’s written request for negotiation, either Party may initiate arbitration as hereinafter provided.

(b) A Party initiating arbitration shall file a demand in accordance with the Commercial Arbitration Rules of the AAA then in effect, except as modified herein (the “Rules”). The arbitration shall be held, and the award shall be rendered, in Boston, Massachusetts, in the English language. There shall be three arbitrators, one of whom shall be nominated by each Party in accordance with the Rules. The two Party-appointed arbitrators shall have 30 days from the confirmation of the nomination of the second arbitrator by the AAA to agree on the nomination of a third arbitrator, who will act as Chairman of the Arbitral Tribunal. If the two arbitrators fail to reach an agreement on the third arbitrator within 30 days of their confirmation by the AAA, the Manager of the AAA for its offices located in Boston, Massachusetts shall appoint the third arbitrator, who will act as the Chairman of the Arbitral Tribunal. The Parties shall use their best efforts to conclude any arbitral proceeding within 180 days from the date that the last arbitrator accepts his or her appointment; provided that if the arbitral award is not issued within such 180 days, then the arbitration proceeding shall continue until an award is made. Each Party shall bear its own costs and attorneys’ fees arising out of the arbitration, except under circumstances in which such costs and fees are otherwise recoverable under applicable law and awarded by the arbitrators. Each Party shall be solely responsible for any filing fees which that Party owes to the AAA on account of any claims and/or counterclaims asserted by such Party during the proceedings. Each Party agrees that any award rendered by the arbitrators shall be final, conclusive and binding on the Parties (including their Affiliates and third parties joined in such arbitration) and may be entered and enforced by any court of competent jurisdiction.

11.14 Construction. The Parties and their respective counsel have participated jointly in the negotiation and drafting of this Agreement. In addition, each of the Parties acknowledges that it is sophisticated and has been advised by experienced counsel and, to the extent it deemed necessary, other advisors in connection with the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement will be construed as if drafted jointly by the Parties and no presumption or burden of proof will arise favoring or disfavoring any Party by virtue of the authorship of any of the provisions of this Agreement. The Parties intend that each representation, warranty and agreement contained in this Agreement will have independent significance. If any Party has breached any representation, warranty or agreement in any respect, the fact that there exists another representation, warranty or agreement relating to the same subject matter (regardless of the relative levels of specificity) that the Party has not breached will not detract from or mitigate the fact that the Party is in breach of the first representation, warranty or agreement. Any reference to any Law will be deemed to refer to all rules and regulations promulgated thereunder, unless the context requires otherwise.

IN WITNESS WHEREOF, the Company, Buyer and Seller have executed this Asset Purchase Agreement as of the date first above written.

BUYER:

CARRIAGE FUNERAL SERVICES OF CALIFORNIA,
INC.

By: /s/ Kevin P. Musico

Name: Kevin P. Musico

Title: Vice President

THE COMPANY:

THADDEUS ENTERPRISES

By: /s/ Thaddeus Luyben, Sr.

Name: Thaddeus Luyben, Sr.

Title: President

SELLER:

By: /s/ Thaddeus M. Luyben, Sr.

Thaddeus M. Luyben, Sr.

Signature Page to Thaddeus Asset Purchase Agreement

CARRIAGE SERVICES, INC.
COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES
(unaudited and in thousands)

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Fixed charges:					
Interest expense	\$ 16,672	\$ 15,972	\$ 24,770	\$ 17,794	\$ 17,630
Amortization of capitalized expenses related to debt	954	924	754	714	714
Rental expense factor	1,221	1,208	1,268	1,245	1,235
Total fixed charges before capitalized interest	18,847	18,104	26,792	19,753	19,579
Capitalized interest	131	24	46	50	59
Total fixed charges	<u>\$ 18,978</u>	<u>\$ 18,128</u>	<u>\$ 26,838</u>	<u>\$ 19,803</u>	<u>\$ 19,638</u>
Earnings available for fixed charges:					
Earnings (loss) before income taxes and cumulative effect of change in accounting principle	\$ 8,589	\$ 10,401	\$ (1,653)	\$ 6,019	\$ 12,593
Add fixed charges before capitalized interest	18,847	18,104	26,792	19,753	19,579
Total earnings available for fixed charges	<u>\$ 27,436</u>	<u>\$ 28,505</u>	<u>\$ 25,319</u>	<u>\$ 25,772</u>	<u>\$ 32,172</u>
Ratio of earnings to fixed charges (1)	<u>1.45</u>	<u>1.57</u>	<u>0.94</u>	<u>1.30</u>	<u>1.64</u>

- (1) For purposes of computing the ratios of earnings to fixed charges and earnings to fixed charges plus dividends: (i) earnings consist of income from continuing operations before provision for income taxes plus fixed charges (excluding capitalized interest) and (ii) "fixed charges" consist of interest expensed and capitalized, amortization of debt discount and expense relating to indebtedness and the portion of rental expense representative of the interest factor attributable to leases for rental property. There were no dividends paid or accrued on the Company's Common Stock during the periods presented above.

CARRIAGE SERVICES, INC.
SUBSIDIARIES AS OF DECEMBER 31, 2007

NAME	JURISDICTION OF INCORPORATION
Carriage Funeral Holdings, Inc.	Delaware
CFS Funeral Services, Inc.	Delaware
Carriage Holding Company, Inc.	Delaware
Carriage Funeral Services of Michigan, Inc.	Michigan
Carriage Funeral Services of Kentucky, Inc.	Kentucky
Carriage Funeral Services of California, Inc.	California
Carriage Funeral Services of Idaho, Inc.	Idaho
Wilson & Kratzer Mortuaries	California
Rolling Hills Memorial Park	California
Carriage Services of Connecticut, Inc.	Connecticut
CSI Funeral Services of Massachusetts, Inc.	Massachusetts
CHC Insurance Agency of Ohio, Inc.	Ohio
Barnett, Demrow & Ernst, Inc.	Kentucky
Carriage Services of New Mexico, Inc.	New Mexico
Forastiere Family Funeral Services, Inc.	Massachusetts
Carriage Cemetery Services, Inc.	Texas
Carriage Services of Oklahoma, L.L.C.	Oklahoma
Carriage Services of Nevada, Inc.	Nevada
Hubbard Funeral Home, Inc.	Maryland
Carriage Services Capital Trust	Delaware
Carriage Team California (Cemetery), LLC	Delaware
Carriage Team California (Funeral), LLC	Delaware
Carriage Team Florida (Cemetery), LLC	Delaware
Carriage Team Florida (Funeral), LLC	Delaware
Carriage Services of Ohio, LLC	Delaware
Carriage Team Kansas, LLC	Delaware
Carriage Municipal Cemetery Services of Nevada, Inc.	Nevada
Carriage Cemetery Services of California, Inc.	California
Carriage Insurance Agency of Massachusetts, Inc.	Massachusetts
Carriage Internet Strategies, Inc.	Delaware
Carriage Investments, Inc.	Delaware
Carriage Management, L.P.	Texas
Cochrane's Chapel of the Roses, Inc.	California
Horizon Cremation Society, Inc.	California
Carriage Life Events, Inc.	Delaware
Carriage Merger I, Inc.	Delaware
Carriage Merger II, Inc.	Delaware
Carriage Merger III, Inc.	Delaware
Aria Cremation Services, LLC	Delaware
Cloverdale Park, Inc.	Idaho
Cataudella Funeral Home, Inc.	Massachusetts

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Carriage Services, Inc.:

We consent to the incorporation by reference in the previously filed registration statements (No. 333-11435, 333-49053, and 333-62593) on Form S-8 and in the registration statement (No. 333-71902) on Form S-3 of Carriage Services, Inc. (the Company) of our reports dated March 14, 2008, with respect to the consolidated balance sheets of the Company as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for the years ended December 31, 2007, 2006 and 2005, and the effectiveness of internal control over financial reporting as of December 31, 2007 and the effect which reports appear in the December 31, 2007, annual report on Form 10-K of Carriage Services, Inc.

Our report contains an explanatory paragraph that states the Company adopted the provisions of FASB Interpretation No. 48, effective January 1, 2007 and Statement of Financial Accounting Standards No. 123 (revised 2004), effective January 1, 2006.

/s/ KPMG LLP

Houston, Texas
March 14, 2008

I, Melvin C. Payne, certify that:

1. I have reviewed this annual report on Form 10-K of Carriage Services Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure 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 report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. 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
 - d. 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 the 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 control over financial reporting.

Dated: March 14, 2008

/s/ Melvin C. Payne

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

I, Joseph Saporito, certify that:

1. I have reviewed this annual report on Form 10-K of Carriage Services Inc.;
2. Based on my knowledge, this annual 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 annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. designed such disclosure controls and procedures, or caused such disclosure 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 report is being prepared;
 - b. designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. 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
 - d. 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 the 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 control over financial reporting.

Dated: March 14, 2008

/s/ Joseph Saporito

Joseph Saporito
Executive Vice President and
Chief Financial Officer

In connection with the Annual Report of Carriage Services, Inc. (the "Company") on Form 10-K for the year ended December 31, 2007 ("Form 10-K"), each of the undersigned officers of the Company certifies pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that to the best of such officer's knowledge: (i) the Form 10-K 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-K fairly presents, in all material respects, the financial condition and results of operations of the Company.

March 14, 2008

/s/ Melvin C. Payne

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

/s/ Joseph Saporito

Joseph Saporito
Executive Vice President and
Chief Financial Officer