CARRIAGE SERVICES INC
Form 10-Q
November 05, 2010

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

OR

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

For the transition period from __________ to __________

Commission file number: 1-11961

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Securities Exchange Act of 1934.

Large accelerated filer o	Accelerated filer þ	Non-Accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the registrant s Common Stock, $.01 par value per share, outstanding as of November 3, 2010 was 17,781,974

CARRIAGE SERVICES, INC.
INDEX

PART I FINANCIAL INFORMATION
Item 1. Financial Statements

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

	December 31, 2009	September 30, 2010 (unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,616	$ 1,346
Accounts receivable, net of allowance for bad debts of $751 in 2009 and $796 in 2010	15,177	14,190
Inventories and other current assets	14,683	10,766
Total current assets	33,476	26,302
Preneed cemetery trust investments	67,901	74,445
Preneed funeral trust investments	75,200	77,703
Preneed receivables, net of allowance for bad debts of $1,158 in 2009 and $1,140 in 2010	16,782	24,046
Receivables from preneed funeral trusts	14,629	21,057
Property, plant and equipment, net of accumulated depreciation of $66,201 in 2009 and $69,992 in 2010	124,800	125,906
Cemetery property	71,661	71,059
Goodwill	166,930	182,508
Deferred charges and other non-current assets	7,536	8,338
Cemetery perpetual care trust investments	40,383	43,438
Total assets	$ 619,298	$ 654,802
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of senior long-term debt and capital lease obligations	$ 558	$ 563
Accounts payable and other liabilities	6,877	7,066
Accrued liabilities	14,037	12,130
Total current liabilities	21,472	19,759
Senior long-term debt, net of current portion	131,898	131,914
Bank credit facility		5,000
Convertible junior subordinated debentures due in 2029 to an affiliate	93,750	92,858
Obligations under capital leases, net of current portion	4,418	4,319
Deferred preneed cemetery revenue	49,176	49,516
Deferred preneed funeral revenue	26,658	39,744
Deferred preneed cemetery receipts held in trust	67,901	74,445
Deferred preneed funeral receipts held in trust	75,200	77,703

Care trusts corpus	40,403	43,455
Total liabilities	510,876	538,713
Commitments and contingencies		
Redeemable preferred stock	200	200
Stockholders equity:		
Common Stock, $.01 par value; 80,000,000 shares authorized; 20,411,000 and 20,860,000 shares issued at December 31, 2009 and September 30, 2010, respectively	204	209
Additional paid-in capital	197,034	199,351
Accumulated deficit	(79,016)	(73,095)
Treasury stock, at cost; 3,109,000 and 3,153,000 shares at December 31, 2009 and shares September 30, 2010, respectively	(10,000)	(10,576)
Total stockholders equity	108,222	115,889
Total liabilities and stockholders equity	$ 619,298	$ 654,802

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

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

	For the three months ended September 30, 2009	For the three months ended September 30, 2010	For the nine months ended September 30, 2009	For the nine months ended September 30, 2010
Revenues:				
Funeral	$ 30,580	$ 33,292	$ 97,216	$ 101,817
Cemetery	11,587	12,193	35,304	35,032
	42,167	45,485	132,520	136,849
Field costs and expenses:				
Funeral	20,191	22,866	61,944	65,956
Cemetery	8,386	8,329	24,893	23,462
Depreciation and amortization	2,043	2,184	6,617	6,417
Regional and unallocated funeral and cemetery costs	1,576	2,047	4,769	5,405
	32,196	35,426	98,223	101,240
Gross profit	9,971	10,059	34,297	35,609
Corporate costs and expenses:				
General and administrative costs and expenses	3,530	3,808	10,621	11,375
Home office depreciation and amortization	398	314	1,223	1,038
	3,928	4,122	11,844	12,413
Operating income	6,043	5,937	22,453	23,196
Interest expense	(4,598)	(4,571)	(13,857)	(13,696)
Interest income and other, net	1	1	224	470
Total interest and other	(4,597)	(4,570)	(13,633)	(13,226)
Income before income taxes	1,446	1,367	8,820	9,970
Provision for income taxes	(586)	(508)	(3,572)	(4,038)
Net income	860	859	5,248	5,932
Preferred stock dividend	4	4	11	11
Net income available to common stockholders	$ 856	$ 855	$ 5,237	$ 5,921
Basic earnings per common share:	$ 0.05	$ 0.05	$ 0.30	$ 0.34
Diluted earnings per common share:	$ 0.05	$ 0.05	$ 0.29	$ 0.33

Weighted average number of common and common equivalent shares outstanding:				
Basic	17,379	17,520	17,658	17,549
Diluted	17,600	17,726	17,822	17,775

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

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

	For the nine months ended September 30, 2009	2010
Cash flows from operating activities:		
Net income	$ 5,248	$ 5,932
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,840	7,455
Amortization of deferred financing costs	587	545
Gain on purchase of convertible junior subordinated debentures		(316)
Provision for losses on accounts receivable	2,804	2,813
Stock-based compensation expense	1,252	1,396
Deferred income taxes	3,572	500
Other	(108)	(149)
Changes in operating assets and liabilities that provided (required) cash:		
Accounts and preneed receivables	(5,014)	(2,252)
Inventories and other current assets	175	2,015
Preneed funeral and cemetery trust investments	(4,548)	(987)
Accounts payable and accrued liabilities	(5,720)	(1,799)
Litigation settlement	(3,300)	
Deferred preneed funeral and cemetery revenue	438	316
Deferred preneed funeral and cemetery receipts held in trust	4,692	1,080
Net cash provided by operating activities	7,918	16,549
Cash flows from investing activities:		
Acquisitions		(16,792)
Net proceeds from the sale of assets	66	400
Capital expenditures	(6,064)	(6,892)
Net cash used in investing activities	(5,998)	(23,284)
Cash flows from financing activities:		
Net borrowings under bank credit facility		5,000
Payments on senior long-term debt and obligations under capital leases	(557)	(346)
Proceeds from the exercise of stock options and employee stock purchase plan	242	441
Purchase of treasury stock	(3,251)	
Dividend on redeemable preferred stock	(11)	(11)
Purchase of convertible junior subordinated debentures		(576)
Other financing costs	(94)	(43)
Net cash provided by (used in) financing activities	(3,671)	4,465

Net decrease in cash and cash equivalents		(1,751)		(2,270)
Cash and cash equivalents at beginning of period		5,007		3,616
Cash and cash equivalents at end of period	$	3,256	$	1,346

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

CARRIAGE SERVICES, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

Carriage Services, Inc. (Carriage or the Company) is a leading provider of deathcare services and merchandise in the United States. As of September 30, 2010, the Company owned and operated 146 funeral homes in 25 states and 33 cemeteries in 12 states**.**

Principles of Consolidation

The accompanying Consolidated Financial Statements include the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

Interim Condensed Disclosures

The information for the three and nine month periods ended September 30, 2009 and 2010 is unaudited, but in the opinion of management, reflects all adjustments which are normal, recurring and necessary for a fair presentation of financial position and results of operations as of and for the interim periods presented. Certain information and footnote disclosures, normally included in annual financial statements, have been condensed or omitted. The accompanying Consolidated Financial Statements have been prepared consistent with the accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2009 and should be read in conjunction therewith.

Cash and Cash Equivalents

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

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 our estimates and judgments, including those related to revenue recognition, realization of accounts receivable, goodwill, 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.

Business Combinations

The Company s growth strategy includes the execution of its Strategic Acquisition Model. The goal of that model is to build concentrated groups of businesses in ten to fifteen strategic markets. The Company assesses acquisition candidates using six strategic ranking criteria to differentiate the pricing the Company is willing to pay. Those criteria are:

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

We 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 and are expensed as incurred. The Company did not acquire any businesses during the nine months ended September 30, 2009. See Note 3 to the Consolidated Financial Statements for information pertaining to the acquisition made during the third quarter of 2010.

Stock Plans and Stock-Based Compensation

The Company has stock-based employee and director compensation plans in the form of restricted stock, performance units, stock options and employee stock purchase plans, which are described in more detail in Note 16 to the Consolidated Financial Statements in our Form 10-K for the year ended December 31, 2009. The Company recognizes compensation expense in an amount equal to the fair value of the share-based awards issued over the period of vesting. Fair value is determined on the date of the grant. The fair value of options or awards containing options is determined using the Black-Scholes valuation model. See Note 12 to the Consolidated Financial Statements herein 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.

Effective January 1, 2009, the accounting method changed for unvested share-based payment awards included in the calculation of earnings per share. Share-based awards that contain nonforfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are recognized as participating securities and included in the computation of both basic and diluted earnings per share. Our grants of restricted stock awards to our employees and directors are considered participating securities and we have prepared our earnings per share calculations to include outstanding unvested restricted stock awards in both the basic and diluted weighted average shares outstanding calculation. For the three and nine month periods ended September 30, 2009 and 2010, there was no material impact to basic and diluted earnings per share as presented in Exhibit 11.1.

Preneed Funeral and Cemetery Trust Funds

The Company s preneed and perpetual care trust funds are reported in accordance with the principles of consolidating Variable Interest Entities. 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 financial interests of third parties in the trust funds in our financial statements as *Deferred preneed funeral and cemetery receipts held in trust* and *Care trusts corpus*. The investments of such trust funds are classified as available-for-sale and are reported at fair market value; therefore, the unrealized gains and losses, as well as accumulated and undistributed income and realized gains and losses are recorded to *Deferred preneed funeral and cemetery receipts held in trust* and *Care trusts corpus* in the Company s Consolidated Balance Sheets. The Company s future obligations to deliver merchandise and services are reported at estimated settlement amounts. Preneed funeral and cemetery trust investments are reduced by the trust investment earnings that we have been allowed to withdraw in certain states prior to maturity. These earnings, along with preneed contract collections not required to be placed in trust, are recorded in *Deferred preneed funeral revenue* and *Deferred preneed cemetery revenue* until the service is performed or the merchandise is delivered.

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.

Fair Value Measurements

We define fair value as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). We disclose the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date. Additional required disclosures are provided in Note 9 to the Consolidated Financial Statements. We have not elected to measure any additional financial instruments and certain other items at fair value that are not currently required to be measured at fair value.

New guidance was issued during early 2009 on how to determine the fair value of assets and liabilities in an environment where the volume and level of activity for the asset or liability have significantly decreased. The new guidance reemphasizes that the objective of a fair value measurement remains an exit price. This guidance was effective for interim reporting periods ending after June 15, 2009 and it has had no effect on our financial position or results of operations.

New guidance was also issued during early 2009 that modifies the requirements for recognizing other-than-temporary impairment on debt securities and significantly changes the impairment model for such securities. The Company considers an impairment of debt and equity securities other-than-temporary unless (a) the investor has the ability and intent to hold an investment and (b) evidence indicating the cost of the investment is recoverable before the Company is more likely than not required to sell the investment. If impairment is indicated, then an adjustment will be made to reduce the carrying amount to fair value. This new guidance also modified the presentation of other-than-temporary impairment losses and increased related disclosure requirements. This change was effective for interim reporting periods ending after June 15, 2009 and it has had no effect on our financial position or results of operations.

In the ordinary course of business, we are typically exposed to a variety of market risks. Currently, these are primarily related to changes in fair 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. The 7 % Senior Notes were issued to the public at par and are carried at a cost of $130 million. At September 30, 2010, these securities were typically trading at a price of approximately $99.25, indicating a fair market value of approximately $129 million. The convertible junior subordinated debentures, payable to Carriage Services Capital Trust, pay interest at the fixed rate of 7% and are carried on our Consolidated Balance Sheets at a cost of approximately $92.9 million. The fair value of these securities is estimated to be approximately $56 million at September 30, 2010 based on available broker quotes of the corresponding preferred securities issued by the Trust.

Accounting for Income Tax Uncertainties

The Company analyzes tax benefits for uncertain tax positions and how they are to be recognized, measured, and derecognized in financial statements; provides certain disclosures of uncertain tax matters; and specifies how reserves for uncertain tax positions should be classified on the Consolidated Balance Sheets. The Company has reviewed its income tax positions and identified certain tax deductions, primarily related to business acquisitions that are not certain. Our policy with respect to potential penalties and interest is to record them as Other expense and Interest expense, respectively. 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 three months.

The Company has unrecognized tax benefits for federal and state income tax purposes totaling approximately $7.3 million as of September 30, 2010, resulting from deductions totaling $19.0 million on federal and various state returns not considered more likely than not to be recognized. The Company has federal and state net operating loss carryforwards offsetting some of those deductions and has accounted for these unrecognized tax benefits by reducing the deferred income tax asset related to the net operating loss carryforwards by the amount of these unrecognized deductions. For the federal and certain states with net operating loss carryforwards that are inadequate to offset these deductions, the Company has increased its taxes payable.

The entire balance of unrecognized tax benefits, if recognized, would affect the Company s provision for income taxes. The recognition of tax benefits for uncertain tax positions was not material for the periods ended September 30, 2009 and 2010. For the nine months ended September 30, 2010, the company s uncertain tax position liability increased by $1.2 million as a result of utilizing the prior year net operating losses previously only accounted for as unrecognized tax benefits. The Company anticipates a likewise increase in its uncertain tax position liability relating to the additional utilization of prior year tax net operating losses during the next three months of an additional $0.9 million. The amount of penalty and interest recognized in the Consolidated Balance Sheets and Consolidated Statement of Operations was not material for the period ended September 30, 2010.

The Company s federal income tax returns for 2001 through 2009 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 2002 through 2009.

Variable Interest Entities

Effective January 1, 2010, new guidance amended the current practice of accounting for Variable Interest Entities (VIE) requiring an enterprise to perform an analysis to determine whether the enterprise s variable interest(s) give it a controlling interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise that has both the power to direct the activities of a VIE that most significantly impact the entity s economic performance and the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. This new guidance did not have a material impact on our Consolidated Financial Statements. Also refer to *Preneed Funeral and Cemetery Trust Funds* in Note 1 to the Consolidated Financial Statements herein for additional information on the Company s VIE entities.

2. RECENTLY ISSUED ACCOUNTING STANDARDS

Fair Value Measurements

In January 2010, new guidance was issued which requires additional fair value disclosures to disclose transfers in and out of Levels 1 and 2 and requires gross presentation of purchases, sales, issuances and settlements in the Level 3 reconciliation of the three-tier fair value hierarchy. This guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements related to Level 3 activity. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The disclosure requirements on transfers between Levels 1 and 2 were effective for the Company as of March 31, 2010. The Company currently does not have any assets that have fair values determined by Level 3 inputs and no liabilities measured at fair value. See Note 9 to the Consolidated Financial Statements herein for additional information on the Company s fair value disclosures.

3. ACQUISITIONS

During the third quarter of 2010, the Company acquired a funeral home business in Huntington Beach, California. The consideration paid for this business was $1.3 million in cash. 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 although, since this acquisition was acquired late in the quarter, the impact to the third quarter operating results was immaterial.

The effect of the acquisition on the Consolidated Balance Sheet at September 30, 2010 was as follows (in thousands):

Current assets	$ 6
Property, plant & equipment	45
Goodwill	1,222
Receivables from preneed funeral trusts	163
Deferred preneed funeral revenue	(163)
	$ 1,273

4. GOODWILL

Many of the acquired funeral homes, former owners and staff 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 business acquisition transactions accounted for as purchases, is recorded as goodwill.

The following table presents the changes in goodwill in the accompanying Consolidated Balance Sheet (in thousands)*:*

		September 30, 2010
Goodwill at beginning of year	$	166,930
Acquisitions		15,578
Goodwill at end of period	$	182,508

5. 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 components of Preneed cemetery trust investments in our Consolidated

Balance Sheets at December 31, 2009 and September 30, 2010 are as follows (in thousands):

	December 31, 2009	September 30, 2010
Preneed cemetery trust investments	$ 67,901	$ 76,402
Less: allowance for contract cancellation	(2,037)	(1,957)
	$ 65,864	$ 74,445

Upon cancellation of a preneed 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.

The cost and fair market values associated with preneed cemetery trust investments at September 30, 2010 are detailed below (in thousands). The Company determines whether or not the assets in the preneed cemetery trusts have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria, including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis due to an other-than-temporary impairment is recorded in Deferred preneed cemetery receipts held in trust. There will be no impact on earnings unless and until such time that this asset is withdrawn from the trust in accordance with state regulations at an amount that is less than its original basis.

	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	$ 2,311	$	$	$ 2,311
Fixed income securities:				
Corporate debt	30,850	7,101	(284)	37,667
Other	3			3
Common stock	28,506	4,035	(685)	31,856
Mutual funds:				
Equity	3,535	210		3,745
Trust securities	$ 65,205	$ 11,346	$ (969)	$ 75,582
Accrued investment income	$ 820			$ 820
Preneed cemetery trust investments				$ 76,402
Fair market value as a percentage of cost				117.2%

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Due in one year or less	$
Due in one to five years	3,468
Due in five to ten years	6,061
Thereafter	28,141
	$ 37,670

Preneed cemetery trust investment security transactions recorded in Interest income and other, net in the Consolidated Statements of Operations (unaudited) for the three and nine months ended September 30, 2009 and 2010 are as follows (in thousands):

	For the three months	For the nine months

	ended September 30, 2009	2010	ended September 30, 2009	2010
Investment income	$ 625	$ 844	$ 1,966	$ 2,423
Realized gains	1,064	3,182	1,381	8,938
Realized losses	(428)	(27)	(3,985)	(733)
Expenses and taxes	(107)	(130)	(350)	(449)
(Increase) decrease in deferred preneed cemetery receipts held in trust	(1,154)	(3,869)	988	(10,179)
	$	$	$	$

Purchases and sales of investments in the preneed cemetery trusts were as follows (in thousands):

	For the three months ended September 30, 2009	2010	For the nine months ended September 30, 2009	2010
Purchases	$ (15,664)	$ (10,449)	$ (36,437)	$ (42,818)
Sales	15,927	10,028	33,295	41,214

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. Preneed funeral contracts are secured by funds paid by the customer to the Company. Preneed funeral trust investments are reduced by the trust earnings the Company has been allowed to withdraw prior to performance by the Company and amounts received from customers that are not required to be deposited into trust, pursuant to various state laws. The components of Preneed funeral trust investments in our Consolidated Balance Sheets at December 31, 2009 and September 30, 2010 are as follows (in thousands):

	December 31, 2009	September 30, 2010
Preneed funeral trust investments	$ 75,200	$ 79,846
Less: allowance for contract cancellation	(2,256)	(2,143)
	$ 72,944	$ 77,703

Upon cancellation of a preneed funeral 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.

The cost and fair market values associated with preneed funeral trust investments at September 30, 2010 are detailed below (in thousands). The Company determines whether or not the assets in the preneed funeral trusts have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis due to an other-than-temporary impairment is recorded as a reduction to Deferred preneed funeral receipts held in trust. There will be no impact on earnings unless and until such time that this asset is withdrawn from the trust in accordance with state regulations at an amount that is less than its original basis.

	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	$ 12,631	$	$	$ 12,631
Fixed income securities:				
U.S. Treasury debt	5,469	172	(3)	5,638
Mortgage backed securities	694	41		735
Corporate debt	22,205	5,738	(104)	27,839
Common stock	19,373	2,489	(569)	21,293
Mutual funds:				
Equity	6,235	155	(443)	5,947
Fixed income	4,816	452	(35)	5,233
Trust securities	$ 71,423	$ 9,047	$ (1,154)	$ 79,316
Accrued investment income	$ 530			$ 530

Preneed funeral trust investments	$ 79,846
Fair market value as a percentage of cost	111.8%

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Due in one year or less	$ 1,977
Due in one to five years	5,873
Due in five to ten years	4,772
Thereafter	21,590
	$ 34,212

Preneed funeral trust investment security transactions recorded in Interest income and other, net in the Consolidated Statements of Operations (unaudited) for the three and nine months ended September 30, 2009 and 2010 are as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	**2010**	**2009**	**2010**
Investment income	$ 773	$ 845	$ 1,972	$ 2,425
Realized gains	1,841	4,469	2,539	9,645
Realized losses	(377)	(20)	(5,984)	(496)
Expenses and taxes	(222)	(154)	(630)	(662)
(Increase) decrease in deferred preneed funeral receipts held in trust	(2,015)	(5,140)	2,103	(10,912)
	$	$	$	$

Purchases and sales of investments in the preneed funeral trusts were as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	**2010**	**2009**	**2010**
Purchases	$ (12,634)	$ (1,520)	$ (34,642)	$ (3,972)
Sales	9,009	17	30,783	2,791

6. RECEIVABLES FROM PRENEED FUNERAL TRUSTS

The receivables from preneed funeral trusts 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 (in thousands).

	December 31, 2009	**September 30, 2010**
Preneed funeral trust funds	$ 16,329	$ 21,708
Less: allowance for contract cancellation	(1,700)	(651)
	$ 14,629	$ 21,057

7. CONTRACTS SECURED BY INSURANCE

Certain preneed funeral contracts are secured by life insurance contracts. 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. Preneed funeral contracts secured by insurance totaled $195.0 million and $204.0 million at December 31, 2009 and September 30, 2010, respectively, and are not included in the Company s Consolidated Balance Sheets.

8. CEMETERY PERPETUAL CARE TRUST INVESTMENTS

Cemetery Care trusts corpus on the Consolidated Balance Sheets represent the corpus of those trusts plus undistributed income. The components of Cemetery Care trusts corpus as of December 31, 2009 and September 30, 2010 are as follows (in thousands):

	December 31,	**September 30,**

		2009		2010
Trust assets, at fair value	$	40,383	$	43,438
Pending withdrawals of income from trust				
Obligations due to trust		20		17
Care trusts corpus	$	40,403	$	43,455

The Company is required by various state laws to pay a portion of the proceeds from the sale of cemetery property interment rights into perpetual care trust funds. The following table reflects the cost and fair market values associated with the trust investments held in perpetual care trust funds at September 30, 2010 (in thousands). The Company determines whether or not the assets in the cemetery perpetual care trusts have an other-than-temporary impairment on a security-by-security basis. This assessment is made based upon a number of criteria, including the length of time a security has been in a loss position, changes in market conditions and concerns related to the specific issuer. If a loss is considered to be other-than-temporary, the cost basis of the security is adjusted downward to its fair market value. Any reduction in the cost basis due to an other-than-temporary impairment is recorded as a reduction to Care trusts corpus.

	Cost	Unrealized Gains	Unrealized Losses	Fair Market Value
Cash and money market accounts	$ 1,179	$	$	$ 1,179
Fixed income securities:				
Corporate debt	20,870	4,753	(178)	25,445
Common stock	14,978	1,721	(438)	16,261
Mutual funds:				
Equity	64		(26)	38
Fixed income	16		(4)	12
Trust securities	$ 37,107	$ 6,474	$ (646)	$ 42,935
Accrued investment income	$ 503			$ 503
Cemetery perpetual care trust investments				$ 43,438
Fair market value as a percentage of cost				117.1%

The estimated maturities of the fixed income securities included above are as follows (in thousands):

Due in one year or less	$
Due in one to five years	3,000
Due in five to ten years	5,160
Thereafter	17,285
	$ 25,445

Perpetual care trust investment security transactions recorded in Interest income and other, net in the Consolidated Statements of Operations (unaudited) for the three and nine months ended September 30, 2009 and 2010 are as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30	
	2009	2010	2009	2010
Undistributable realized gains	$ 1,652	$ 1,037	$ 1,831	$ 3,579
Undistributable realized losses	(1,184)	(3)	(3,152)	(741)
Decrease (increase) in Care trusts corpus	(468)	(1,034)	1,321	(2,838)
	$	$	$	$

Perpetual care trust investment security transactions recorded in Cemetery revenue for the three and nine months ended September 30, 2009 and 2010 are as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2010	2009	2010
Investment income	$ 629	$ 288	$ 1,795	$ 1,521
Realized gains	(3)	682	154	1,532
Expenses	(63)		(158)	(21)
Total	$ 563	$ 970	$ 1,791	$ 3,032

Purchases and sales of investments in the perpetual care trusts were as follows (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2010	2009	2010
Purchases	$ (17,234)	$ (6,757)	$ (32,484)	$ (29,831)
Sales	18,439	7,498	32,314	31,060

9. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date applicable for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. We disclose the extent to which fair value is used to measure financial assets and liabilities, the inputs utilized in calculating valuation measurements, and the effect of the measurement of significant unobservable inputs on earnings, or changes in net assets, as of the measurement date.

The Company evaluated its financial assets and liabilities for those financial assets and liabilities that met the criteria of the disclosure requirements and fair value framework. The Company identified investments in fixed income securities, common stock and mutual funds presented within the preneed and perpetual trust investments categories on the Consolidated Balance Sheets as having met such criteria. The following three-level valuation hierarchy based upon the transparency of inputs is utilized in the measurement and valuation of financial assets or liabilities as of the measurement date:

Level 1 Fair value of securities based on unadjusted quoted prices for identical assets or liabilities in active markets. Our investments classified as Level 1 securities include common stock, certain fixed income securities, and equity mutual funds;

Level 2 Fair value of securities estimated based on quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted market prices that are observable or that can be corroborated by observable market data by correlation. These inputs include interest rates, yield curves, credit risk, prepayment speeds, rating and tax-exempt status. Our investments classified as Level 2 securities include corporate and U.S. agency fixed income securities, and fixed income mutual funds; and

Level 3 Unobservable inputs based upon the reporting entity s internally developed assumptions which market participants would use in pricing the asset or liability. As of September 30, 2010, the Company did not have any assets that had fair values determined by Level 3 inputs and no liabilities measured at fair value.

The Company accounts for its investments as available-for-sale and measures them at fair value under standards of financial accounting and reporting for investments in equity instruments that have readily determinable fair values and for all investments in debt securities.

The table below presents information about our assets measured at fair value on a recurring basis and summarizes the fair value hierarchy of the valuation techniques utilized by us to determine the fair values as of September 30, 2010 (in thousands). Certain fixed income and other securities are reported at fair value using Level 2 inputs. For these securities, the Company uses pricing services and dealer quotes. As of September 30, 2010, the Company did not have any liabilities measured at fair value.

	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	September 30, 2010
Assets:				
Fixed income securities:				
U.S. Treasury debt	$ 5,638	$	$	$ 5,638
Mortgage backed securities		738		738
Corporate debt		90,951		90,951
Common stock	69,410			69,410
Mutual funds:				

Equity	9,730			9,730
Fixed income		5,245		5,245
Total Assets	$ 84,778	$ 96,934	$	$ 181,712

There were no significant transfers between Levels 1 and 2 for the three and nine months ended September 30, 2010.

10. LONG-TERM DEBT

The Company has outstanding a principal amount of $130 million of 7 % unsecured Senior Notes, due in 2015, with interest payable semi-annually. The Company also has a senior secured revolving credit facility (the credit facility) for which borrowings bear interest at prime or LIBOR options with the current LIBOR option set at LIBOR plus 350 basis points and is collateralized by all personal property and by funeral home real property in certain states. At September 30, 2010, $5.0 million was drawn under the credit facility. Additionally, $0.1 million in letters of credit were issued and outstanding under the credit facility at September 30, 2010. Interest is payable quarterly. The credit facility matures in November 2012.

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 7% debentures issued in connection with the issuance of the Trust s TIDES 7% convertible preferred securities) have fully and unconditionally guaranteed the Company s obligations under the 7 % Senior Notes. Additionally, the Company does not currently have any significant restrictions on its ability to receive dividends or loans from any subsidiary guarantor under the 7 % Senior Notes. In June 2010, the Company repurchased 17,850 shares of these TIDES for approximately $0.6 million and recorded a gain of $0.3 million. In September 2010, the Company converted these preferred shares at the current conversion rate of 2.4465 into shares of common stock equal to 43,670 shares. Immediately upon the exchange, these common shares were cancelled and held in Treasury.

The Company was in compliance with the covenants contained in the credit facility and the Senior Notes as of September 30, 2009 and 2010.

11. COMMITMENTS AND CONTINGENCIES

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.

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 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. The Plaintiffs also allege that the claims occurred prior, during and after the Company owned the cemetery. On October 15, 2007, the case was removed from Jefferson County Circuit Court, Indiana to the Southern District of Indiana. On April 24, 2009, shortly before Defendants had been scheduled to file their briefs in opposition to Plaintiffs motion for class certification, Plaintiffs moved to amend their complaint to add new class representatives and claims, while also seeking to abandon other claims. The Company, as well as several other Defendants, opposed Plaintiffs motion to amend their complaint and add parties. In April 2009, two Defendants moved to disqualify Plaintiffs counsel from further representing Plaintiffs in this action. On March 31, 2010, the Court granted the Defendants motion to disqualify Plaintiffs counsel. In that order, the Court gave Plaintiffs sixty (60) days within which to retain new counsel. In addition, all discovery has been stayed and all pending motions including Plaintiffs motion for leave to file an amended complaint and Plaintiffs motion for class certification were dismissed without prejudice to re-file with leave of Court upon retention of new counsel. On May 6, 2010, Plaintiffs filed a petition for writ of mandamus with the Seventh Circuit Court of Appeals seeking relief from the trial court s order of disqualification of counsel. On May 19, 2010, the Defendants responded to the petition of mandamus. On July 8, 2010, the Seventh Circuit denied Plaintiffs petition for writ of mandamus. Thus, pursuant to the trial court s order, the Plaintiffs were given sixty (60) days from July 8, 2010 in which to retain new counsel to prosecute this action on their behalf. Plaintiffs have now retained new counsel and the trial Court has provided the newly retained Plaintiffs counsel ninety (90) days to review the case and advise the Court with respect to whether or not Plaintiffs will seek leave to amend their complaint to add and/or change the allegations as are currently stated therein and whether or not they will seek leave to amend the proposed class representatives for class certification. In addition, the trial Court has ordered that discovery in the matter shall proceed simultaneously with Plaintiffs counsel s review of the case. Carriage intends to 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). In this individual action, Plaintiffs allege improper handling of remains and/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 purchased only Vail-Holt s assets under an asset purchase agreement and did not assume its liabilities. 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. On May 3, 2010, the Court entered an order relieving Carriage from any liability and dismissing all of Plaintiffs cemetery claims against Carriage in the *Kendall v. Carriage Funeral Holdings, Inc.* matter. The Court has not yet ruled on the remaining funeral home allegations against Carriage in the *Kendall* matter which are the subject of its motion. The Company intends to defend this action vigorously. Pending the Court s ruling, 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.

12. STOCK-BASED COMPENSATION

Stock Options and Employee Stock Purchase Plan

No stock options were awarded during the three months ended September 30, 2010. In the second quarter of 2010, a total of 211,401 stock options were awarded to officers and certain employees. The value of these stock options is approximately $0.5 million. The stock options vest in 33 % increments over a three year period and expire May 18, 2020. All other outstanding stock options previously granted have fully vested.

For the third quarter of 2010, employees purchased a total of 29,293 shares of common stock through the employee stock purchase plan (ESPP) at a weighted average price of $3.37 per share. The Company recorded pre-tax stock-based compensation expense for the ESPP and for stock options totaling $30,000 and $75,000 for the three months ended September 30, 2009 and 2010, respectively, and $151,000 and $199,000 for the nine months ended September 30, 2009 and 2010, respectively.

The fair value of the right (option) to purchase shares under the ESPP, is estimated on the date of grant associated with the four quarterly purchase dates using the following assumptions:

	2009	2010
Dividend yield	0%	0%
Expected volatility	76%	70%
Risk-free interest rate	0.09%, 0.27%, 0.31%, 0.35%	0.08%, 0.18%, 0.31%, 0.45%
Expected life (years)	.25, .50, .75, 1	.25, .50, .75, 1

Expected volatilities are based on the historical volatility during the previous twelve months of the underlying common stock. The risk-free rate for the quarterly purchase periods is based on the U.S. Treasury yields in effect at the time of grant (January 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).

Common Stock Grants

The Company, from time to time, issues shares of restricted common stock to certain officers, directors and key employees of the Company from its stock benefit plans. The restricted stock issued to officers and key employees vest in either 25% or 33 % increments over four or three year periods, respectively. No restricted stock was granted during the third quarter of 2010. Related to the vesting of restricted stock awards previously awarded to our officers and employees, the Company recorded $242,000 and $366,000 in pre-tax compensation expense, included in general, administrative and other expenses, for the three months ended September 30, 2009 and 2010, respectively, and $748,000 and $977,000 in pre-tax compensation expense for the nine months ended September 30, 2009 and 2010, respectively.

In 2009, the Company s directors could elect to receive all or a portion of their fees in stock. During the three and nine months ended September 30, 2009, the Company issued 9,797 and 51,718 shares of unrestricted common stock to directors in lieu of payment in cash for their fees, respectively. Effective March 22, 2010, and subsequently revised on July 14, 2010, the Board of Directors approved a new Director Compensation Policy in which the directors no longer have an option to elect to receive all or a portion of their fees in stock. For the three and nine months ended September 30, 2010, all meeting fees were paid in cash. The Company recorded $68,000 and $66,000 in pre-tax compensation expense, included in general, administrative and other expenses, for the three months ended September 30, 2009 and 2010, respectively, and $363,000 and $392,000 in pretax compensation expense for the nine months ended September 30, 2009 and 2010, respectively, related to the director fees and deferred compensation amortization.

As of September 30, 2010, the Company had $2.3 million of total unrecognized compensation costs related to unvested restricted stock awards, which are expected to be recognized over a weighted average period of approximately 2.0 years.

13. RELATED PARTY TRANSACTIONS

The Company engaged a law firm in which one of their partners is the spouse of the Company s Executive Vice President and General Counsel. The firm was used for various legal matters during the periods. During the nine months ended September 30, 2009 and 2010, the amount paid to the firm was $0.3 million and $0.1 million, respectively.

The Company consolidates an entity that provides cremation services in accordance with the accounting for Variable Interest Entities. The Company also provides 100% of the financing needs for the entity. Carriage s Executive Vice President and Chief Operating Officer is a one-third owner in a company that owns 52.8% of this entity. As of September 30, 2010, the entity owed Carriage approximately $1.8 million in the form of a working capital line of credit.

A member of the Company s Board of Directors is a key member of management and Chief Investment Officer of an otherwise unrelated company that holds $7.3 million of the Company s 7 % Senior Notes for investment purposes.

14. MAJOR SEGMENTS OF BUSINESS

Carriage conducts funeral and cemetery operations only in the United States. The following table presents revenue, pre-tax income and total assets by segment (in thousands):

	Funeral	Cemetery	Corporate	Consolidated
Revenues from operating activities:				
Nine months ended September 30, 2010	$ 101,817	$ 35,032	$	$ 136,849
Nine months ended September 30, 2009	$ 97,216	$ 35,304	$	$ 132,520
Income (loss) before income taxes:				
Nine months ended September 30, 2010	$ 28,218	$ 7,115	$ (25,363)	$ 9,970
Nine months ended September 30, 2009	$ 28,026	$ 5,900	$ (25,106)	$ 8,820
Total assets:				
September 30, 2010	$ 400,010	$ 234,726	$ 20,066	$ 654,802
December 31, 2009	$ 370,058	$ 223,743	$ 25,497	$ 619,298

15. SUPPLEMENTAL DISCLOSURE OF STATEMENT OF OPERATIONS INFORMATION

The following information is supplemental disclosure for the Consolidated Statements of Operations (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2009	2010	2009	2010
Revenues				
Goods				
Funeral	$ 12,627	$ 13,077	$ 40,125	$ 40,729
Cemetery	8,075	8,260	25,077	23,248
Total goods	$ 20,702	$ 21,337	$ 65,202	$ 63,977
Services				
Funeral	$ 16,600	$ 18,030	$ 52,578	$ 54,729
Cemetery	2,338	2,440	6,942	7,212
Total services	$ 18,938	$ 20,470	$ 59,520	$ 61,941
Financial revenue				
Preneed funeral commission income	$ 483	$ 632	$ 1,573	$ 1,817
Preneed funeral trust earnings	870	1,553	2,940	4,542
Cemetery trust earnings	802	1,121	2,149	3,369
Cemetery finance charges	372	372	1,136	1,203
Total financial revenue	$ 2,527	$ 3,678	$ 7,798	$ 10,931
Total revenues	$ 42,167	$ 45,485	$ 132,520	$ 136,849
Cost of revenues				
Goods				
Funeral	$ 10,856	$ 11,816	$ 33,632	$ 34,948
Cemetery	6,718	6,613	20,108	18,460
Total goods	$ 17,574	$ 18,429	$ 53,740	$ 53,408
Services				
Funeral	$ 8,853	$ 10,637	$ 26,868	$ 29,937
Cemetery	1,668	1,716	4,785	5,002
Total services	$ 10,521	$ 12,353	$ 31,653	$ 34,939
Financial expenses				
Preneed funeral commissions	$ 482	$ 413	$ 1,444	$ 1,071
Total financial expenses	$ 482	$ 413	$ 1,444	$ 1,071

Total cost of revenues	$ 28,577	$ 31,195	$ 86,837	$ 89,418

The costs of revenues, for purposes of this supplemental disclosure, include only field costs and expenses that are directly allocable between the goods, services and financial categories in the funeral and cemetery segments. Depreciation and amortization and regional and unallocated funeral and cemetery costs are not included in this disclosure.

16. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

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

	For the nine months ended September 30,	
	2009	2010
Cash paid for interest and financing costs	$ 15,961	$ 15,914
Cash paid for income taxes	207	684
Fair value of stock issued to directors or officers	797	1,097
Restricted common stock withheld for payroll taxes	40	90
Net (deposits) withdrawals (into) from preneed funeral trusts	(1,515)	1,111
Net deposits into preneed cemetery trusts	(2,000)	(2,119)
Net deposits into perpetual care trusts	(1,220)	(75)
Net (increase) decrease in preneed funeral receivables	(81)	666
Net increase in preneed cemetery receivables	(2,314)	(1,093)
Net withdrawals of receivables from preneed funeral trusts	187	96
Net change in preneed funeral receivables increasing deferred revenue	288	69
Net change in preneed cemetery receivables increasing deferred revenue	150	247
Net deposits (withdrawals) into (from) preneed funeral trust accounts increasing (decreasing) deferred preneed funeral receipts	1,515	(1,111)
Net deposits in cemetery trust accounts increasing deferred cemetery receipts	2,000	2,119
Net deposits in perpetual care trust accounts increasing perpetual care trusts corpus	1,177	72

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements

In addition to historical information, this Quarterly Report on Form 10-Q 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 operations; any statements regarding future economic conditions or performance; any statements of belief; and any statements of assumptions underlying any of the foregoing. Forward-looking statements may include the words may , will , estimate , intend , believe , expect , p 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, in our Annual Report on Form 10-K for the year ended December 31, 2009.

Cautionary Statements

We caution readers that important factors, in some cases have affected, and in the future could affect, our actual consolidated results and could cause our actual consolidated results in the future to differ materially from the goals and expectations expressed herein and in any other forward-looking statements made by or on behalf of us. Risks associated with our business and the deathcare business are presented in Item 1A., Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2009.

OVERVIEW

General

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 service businesses that provide funeral services (traditional 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 mausoleum spaces) and related merchandise, such as markers and outer burial containers. As of September 30, 2010, we operated 146 funeral homes in 25 states and 33 cemeteries in 12 states within the United States. Substantially all administrative activities are conducted in our home office in Houston, Texas.

We have implemented 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 in 2004 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 line-item financial budgets in favor of the standards. The operating model and standards, which we refer to as the Standards Operating Model 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 of deathcare businesses, which then led to the development of a Strategic Acquisition Model, described below under Acquisitions, during 2006, that guides our acquisition and disposition strategies. Both models, when executed effectively, should drive longer term, sustainable increases in market share, revenue, earnings and 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. Important elements of the Standards Operating Model include:

Balanced Operating Model We believe a decentralized structure works best in the deathcare industry. Successful execution of the Standards Operating Model is highly dependent on strong local leadership, intelligent risk taking, entrepreneurial drive and corporate support aligned with the key drivers.

Incentives Aligned with Standards Empowering Managing Partners to do the right things in their operations and local communities, and providing appropriate support with operating and financial practices, will enable long-term growth and sustainable profitability. Each Managing Partner participates in a variable bonus plan whereby they earn a percentage of their business earnings based upon the actual standards achieved. Each Managing Partner has the opportunity to share in the earnings of the business as long as the performance exceeds our minimum standards.

The Right Local Leadership Successful execution of our operating model is highly dependent on strong local leadership as defined by our 4E Leadership Model, intelligent risk taking and entrepreneurial empowerment. Over time, a Managing Partner s performance is judged according to achievement of the Standards for that business.

Funeral and Cemetery Operations

Factors affecting our funeral operating results include: demographic trends in terms of population growth and average age, which impact death rates and number of deaths; establishing and maintaining leading market share positions supported by strong local heritage and relationships; effectively responding to increasing cremation trends by packaging complementary services and merchandise; controlling salary and merchandise costs; and exercising pricing leverage related to our at-need business to increase average revenues per contract. In simple terms, volume and price are the two variables that affect funeral revenues. The average revenue per contract is influenced by the mix of traditional burial and cremation services because our average cremation service revenue is approximately one-third 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.

Our funeral volumes have increased gradually from 21,665 in 2006 to 24,362 in 2009 (compound annual increase of 3.0%). Our funeral operating revenue has increased from $109.1 million in 2006 to $125.1 million in 2009 (compound annual increase of 3.5%). The increases are primarily because of businesses we acquired in 2007 and 2009 and our ability to increase the average revenue per funeral through expanded service offerings and packages. We experienced an increase of 4.3% in volumes in comparing the first nine months of 2010 to the first nine months of 2009, 0.2% of which resulted from organic growth and 4.1% through acquisitions. Funeral operating revenues for the nine months ended September 30, 2010 were up 3.0% compared to the nine months ended September 30, 2009.

The percentage of funeral services involving cremations has increased from 34.3% for 2006 to 42.1% for 2009 and to 43.6% for the first nine months of 2010. A significant portion of that increase is the result of acquiring businesses in high cremation areas. On a same-store basis, the creation rate has risen to 40.5% for the nine months ended September 30, 2010.

The cemetery operating results are affected by the size and success of our sales organization. Approximately 52% of our cemetery revenues relate to preneed sales of interment rights and mausoleums and related merchandise and services. 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. The current environment of high unemployment and low consumer confidence represents a formidable challenge to the cemetery sales staff. Approximately 13% of our cemetery revenues 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.

Our cemetery financial performance from 2006 through 2009 was characterized by increasing operating revenues and fluctuating field level profit margins. Cemetery revenue decreased by less than 1% as higher trust fund earnings and at-need revenues offset the decline in preneed revenues. Operating profit (Gross profit excluding depreciation and amortization and regional and unallocated costs) increased 11.1%, for the first nine months of 2010 compared to the same period of 2009, as a result of higher trust fund earnings and higher at-need gross profit. Our goal is to build broader and deeper teams of sales leaders and counselors in our larger and more strategically located cemeteries that can sustain consistent, modest growth in preneed property sales over time and to diversify and substantially increase our cemetery operating and financial results. Additionally, a portion of our capital expenditures in 2010 is designed to expand our cemetery product offerings.

Financial Revenue

We 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 deathcare plans at the time of need and allow input from other family members before the death occurs. We guarantee the price and performance of the preneed contracts to the customer.

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. Additionally, we generally earn a commission from the insurance company from the sale of insurance-funded policies reflected as *Preneed Insurance Commission*. 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).

Preneed sales of cemetery interment rights are usually financed through interest-bearing installment sales contracts, generally with terms of up to five years with such earnings reflected as *Preneed Cemetery Finance Charges*. In substantially all cases, we receive an initial down payment at the time the contract is signed. The interest rates generally range between 9.5% and 12% per annum. Occasionally, we have offered zero percent interest financing to promote sales for limited-time offers. 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.

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 trust fund income earned and the receipt and recognition of any insurance benefits are deferred until the service is performed. Applicable state laws generally require us 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 preneed cemetery merchandise and service sales. The related trust fund income earned is recognized when the related merchandise and services are delivered. The income from 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.

Acquisitions

Our growth strategy includes the execution of the Strategic Acquisition Model. The goal of that model is to build concentrated groups of businesses in ten to fifteen strategic markets. We use six strategic ranking criteria to assess acquisition candidates 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; and
- Barriers to entry.

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. We derive the pre-tax earnings amounts based primarily on the size and product mix of the target business applied to our standards-based operating model. In 2009, we completed two acquisitions. We closed four acquisitions in the second quarter of 2010. The consideration paid for those acquired businesses in the second quarter of 2010 was $15.5 million in cash and the assumption of $0.6 million of liabilities and debt. During the third quarter of 2010, we completed one acquisition. The consideration paid for this business was $1.3 million in cash.

Financial Highlights

Net income for the three months ended September 30, 2010 totaled $0.9 million, equal to $0.05 per diluted share, the same as reported for the three months ended September 30, 2009. Despite a 7.9% increase in total revenue, the third quarter of 2010 net income was negatively affected by acquisition transaction costs and increases in field incentive compensation and self insurance costs. Net income for the nine months ended September 30, 2010 totaled $5.9 million, equal to $0.33 per diluted share, compared to $5.2 million, equal to $0.29 per diluted share, for the nine months ended September 30, 2009. The variance between the two periods is primarily attributable to higher trust fund earnings. The business acquired in the third quarter of 2010 did not have a material impact on our current results.

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, goodwill, other 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 (MD&A) is 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 more fully described in Note 1 to our Consolidated Financial Statements. Our critical accounting policies are those that are both important to the portrayal of our financial condition and results of operations and require management s most difficult, subjective and complex judgment. These critical accounting policies are discussed in MD&A in our 2009 Form 10-K. There have been no significant changes to our critical accounting policies since the filing of our 2009 Form 10-K.

RESULTS OF OPERATIONS

The following is a discussion of our results of operations for the three and nine month periods ended September 30, 2009 and 2010. The term same-store or existing operations refers to funeral homes and cemeteries acquired prior to January 1, 2006 and owned and operated for the entirety of each period being presented. Funeral homes and cemeteries purchased after January 1, 2006 are referred to as acquired. This classification of acquisitions has been important to management and investors in monitoring the results of these businesses and to gauge the leveraging performance contribution that a selective acquisition program can have on the total company performance. Depreciation and amortization and regional and unallocated funeral and cemetery costs are not included in operating profit.

Funeral Home Segment. The following table sets forth certain information regarding the revenues and operating profit from the funeral home operations for the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2010.

Three months ended September 30, 2009 compared to three months ended September 30, 2010 (dollars in thousands):

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2010	Change Amount	Change %
Revenues:				
Same-store operating revenue	$ 25,442	$ 25,317	$ (125)	(0.5)%
Acquired operating revenue	3,785	5,790	2,005	53.0%
Preneed funeral insurance commissions	483	632	149	*
Preneed funeral trust earnings	870	1,553	683	78.5%
Total	$ 30,580	$ 33,292	$ 2,712	8.9%
Operating profit:				
Same-store operating profit	$ 8,570	$ 7,806	$ (764)	(8.9)%
Acquired operating profit	948	848	(100)	(10.5)%
Preneed funeral insurance commissions	1	219	218	*
Preneed funeral trust earnings	870	1,553	683	78.5%
Total	$ 10,389	$ 10,426	$ 37	0.4%

* not meaningful

Funeral same-store operating revenues for the three months ended September 30, 2010 decreased $0.1 million, or 0.5%, when compared to the three months ended September 30, 2009. We experienced a 1.6% increase in the number of contracts and the average revenue per contract increased 0.2% for those existing operations at $5,553. The average revenue per contract includes the impact of the funeral trust fund earnings recognized at the time that we provide the needed services for preneed families. The number of traditional burial contracts remained flat while the average revenue per burial contract increased 1.6% to $8,083. The cremation rate for the same-store businesses rose from 40.1% to 41.5%. The average revenue per same-store cremation contract increased 1.5% to $3,100 and the number of cremation contracts increased 5.1%. Cremations with services declined from 47.1% of total cremation contracts in the third quarter of 2009 to 42.2% in the third quarter of 2010. The average revenue for other contracts, which make up approximately 7.6% of the number of contracts, declined from $2,127 to $1,989. Other contracts consist of charges for merchandise or services for which we do not perform a funeral service for the deceased during the period.

Same-store operating profit for the three months ended September 30, 2010 decreased $0.8 million, or 8.9%, from the comparable three months of 2009, and as a percentage of funeral same-store operating revenue, decreased from

33.7% to 30.8%. A combined increase of $0.6 million is self-insured costs, along with the decline in revenues were the primary reason for the decline in operating profit. Those costs were primarily medical and workers compensation claims.

Funeral acquired revenues for the three months ended September 30, 2010 increased $2.0 million, or 53.0%, when compared to the three months ended September 30, 2009 as we experienced a 57.3% increase in the number of contracts, due to the acquisitions completed in the second and third quarters of 2010, yet a decrease of 2.2%, to $3,799, in the average revenue per contract for those acquired operations. The 2010 period includes the results of operation attributable to the two acquisitions that closed in the fourth quarter of 2009, the three funeral businesses acquired in the second quarter and, to a lesser extent, the one funeral business that closed late in the third quarter. The cremation rate for the acquired businesses was 60.2% for the third quarter of 2010, up from 54.4% in the prior year period, as these businesses are located in higher cremation areas compared to our existing locations. The average revenue per cremation contract increased 12.5% to $2,387 for the third quarter of 2010 and the number of cremation contracts increased 73.9% compared to the same period of 2009.

Acquired operating profit for the three months ended September 30, 2010 declined $0.1, or 10.5%, from the comparable three months of 2009 and, as a percentage of revenue from acquired businesses, was 25.0% for the third quarter of 2009 compared to 14.6% for the third quarter of 2010 as those recently acquired businesses have not fully transitioned into Carriage s Standard Operating Model.

The two categories of financial revenue, insurance commissions and trust earnings on matured preneed contracts, had a meaningful impact on funeral revenues and profit. On a combined basis, these categories experienced an increase of $0.8 million and $0.9 million in revenue and operating profit, respectively, compared to the third quarter of 2009 primarily due to higher realization of interest income, dividends and capital gains that have been allocated to individual maturing contracts and lower preneed expenses.

Nine months ended September 30, 2009 compared to nine months ended September 30, 2010 (dollars in thousands):

	Nine Months Ended September 30,		**Change**	
	2009	**2010**	**Amount**	**%**
Revenues:				
Same-store operating revenue	$ 80,519	$ 79,984	$ (535)	0.7%
Acquired operating revenue	12,184	15,474	3,290	27.0%
Preneed funeral insurance commissions	1,573	1,817	244	*
Preneed funeral trust earnings	2,940	4,542	1,602	54.5%
Total	$ 97,216	$ 101,817	$ 4,601	4.7%
Operating profit:				
Same-store operating profit	$ 28,702	$ 26,975	$ (1,727)	(6.0)%
Acquired operating profit	3,501	3,599	98	2.8%
Preneed funeral insurance commissions	129	746	617	*
Preneed funeral trust earnings	2,940	4,542	1,602	54.5%
Total	$ 35,272	$ 35,862	$ 590	1.7%

* not meaningful

Funeral same-store operating revenues for the nine months ended September 30, 2010 decreased $0.5 million, or 0.7%, when compared to the nine months ended September 30, 2009. We experienced a 0.2% increase in the number of contracts and an increase of 0.8%, to $5,605, in the average revenue per contract for those existing operations. The average revenue per contract includes the impact of the funeral trust fund earnings on matured contracts. The number of traditional burial contracts decreased 2.6%, while the average revenue per burial contract increased 2.4% to $8,088. The cremation rate for the same-store businesses rose from 39.5% to 40.5%. The average revenue per cremation contract increased 4.1% to $3,096 and the number of cremation contracts increased 2.7%. Cremations with services declined from 45.9% of total cremation contracts in the third quarter of 2009 to 44.9% in the third quarter of 2010.

Same-store operating profit for the nine months ended September 30, 2010 decreased $1.7 million, or 6.0%, from the comparable nine months of 2009 and, as a percentage of funeral same-store operating revenue, decreased from 35.6% to 33.7%. Self-insured healthcare costs rose $0.6 million year over year and along with the decline in operating revenues represents the majority of decline in operating profit.

Acquired funeral homes generated $15.5 million in revenue, equal to 15.2% of our funeral home revenue and $3.6 million in operating profit, equal to 10.0% of our funeral home operating profit. The average revenue per contract for the acquired businesses was $4,100 and the cremation rate was 55.4% for the nine months ended September 30, 2010. For the nine months ended September 30, 2009, the average revenue per contract was $3,977, and the cremation rate was 53.2%.

Financial revenue and profit for the nine months ended September 30, 2010 increased $1.8 million and $2.2 million, respectively, compared to the nine months ended September 30, 2009, primarily because of higher realization of interest income, dividends and capital gains that have been allocated to individual maturing contracts and lower preneed expenses.

Cemetery Segment. The following table sets forth certain information regarding our revenues and operating profit from the cemetery operations for the three and nine months ended September 30, 2009 compared to the three and nine months ended September 30, 2010.

Three months ended September 30, 2009 compared to three months ended September 30, 2010 (dollars in thousands):

	Three Months Ended September 30,		**Change**	
	2009	**2010**	**Amount**	**%**
Revenues:				
Same-store operating revenue	$ 8,881	$ 9,030	$ 149	1.7%
Acquired operating revenue	1,532	1,670	138	9.0%
Cemetery trust earnings	802	1,121	319	39.8%
Preneed cemetery finance charges	372	372		0.0%
Total	$ 11,587	$ 12,193	$ 606	5.2%
Operating profit:				
Same-store operating profit	$ 1,825	$ 1,885	$ 60	3.3%
Acquired operating profit	202	486	284	140.6%
Cemetery trust earnings	802	1,121	319	39.8%
Preneed cemetery finance charges	372	372		0.0%
Total	$ 3,201	$ 3,864	$ 663	20.7%

Cemetery same-store operating revenues for the three months ended September 30, 2010 increased $0.1 million, or 1.7%, compared to the three months ended September 30, 2009. Same-store revenue from preneed property sales increased $0.2 million, revenue from deliveries of preneed merchandise and services deliveries decreased $0.4 million, or 25.7%, and at-need revenues increased $0.3 million, or 8.7%.

Cemetery same-store operating profit for the three months ended September 30, 2010 decreased $0.1 million, or 3.3%. As a percentage of revenues, cemetery same-store operating profit increased slightly from 20.5% to 20.9%. Promotional expenses (primarily preneed sales commissions) remained flat and bad debts increased $0.1 million, or 14.5%, offset by higher at-need gross profit.

Cemetery acquired revenues for the three months ended September 30, 2010 increased $0.1 million, or 9.0%, compared to the three months ended September 30, 2009. Acquired revenue from preneed property sales increased $0.1 million and preneed revenue from merchandise and services deliveries decreased slightly while at-need revenues increased $0.1 million, or 17.0%. Cemetery acquired operating profit increased $0.3 million due to the increase in revenue.

The two categories of financial revenue which consist of trust earnings and finance charges on preneed receivables had a meaningful impact on cemetery revenues and operating profit. Total trust earnings increased $0.3 million, or 39.8%, when compared to the three months ended September 30, 2009. Earnings from perpetual care trust funds totaled $1.0 million for the three months ended September 30, 2010 compared to $0.6 million for the three months ended September 30, 2009. Trust earnings recognized upon the delivery of merchandise and service contracts decreased $0.1 million, or 36.5%, compared to the same period in 2009. Finance charges on the preneed contracts were relatively flat.

Nine months ended September 30, 2009 compared to nine months ended September 30, 2010 (dollars in thousands):

	Nine Months Ended September 30,		Change	
	2009	2010	Amount	%
Revenues:				
Same-store operating revenue	$ 27,219	$ 25,702	$ (1,517)	(5.6)%
Acquired operating revenue	4,800	4,758	(42)	(0.9)%
Cemetery trust earnings	2,149	3,369	1,220	56.8%
Preneed cemetery finance charges	1,136	1,203	67	5.9%
Total	$ 35,304	$ 35,032	$ (272)	(0.8)%
Operating profit:				
Same-store operating profit	$ 6,014	$ 5,629	$ (385)	(6.4)%
Acquired operating profit	1,112	1,369	257	23.1%
Cemetery trust earnings	2,149	3,369	1,220	56.8%
Preneed cemetery finance charges	1,136	1,203	67	5.9%
Total	$ 10,411	$ 11,570	$ 1,159	11.1%

Cemetery same-store operating revenues for the nine months ended September 30, 2010, decreased $1.5 million, or 5.6%, compared to the nine months ended September 30, 2009. Same-store revenue from preneed property sales decreased $1.6 million, or 12%, which was primarily a reflection of a 14.7% decrease in the number of interment rights (property) sold and a 9.6% increase in the average price per interment. The percentage of those we were able to recognize as revenue, because we received at least 10% of the sales price from the customer, decreased from 87.5% to 82.2%. Revenue from deliveries of preneed merchandise and services deliveries decreased $0.5 million, or 11.7% and same-store at-need revenues increased $0.6 million, or 6.2%.

Cemetery same-store operating profit for the nine months ended September 30, 2010 decreased $0.4 million, or 6.4% primarily due to the decline in revenues. As a percentage of revenues, cemetery same-store operating profit decreased slightly from 22.1% to 21.9%. Promotional expenses (primarily preneed sales commissions) decreased $0.6 million and bad debts decreased $0.3 million in correlation with the lower preneed sales volumes.

Cemetery acquired revenues for the nine months ended September 30, 2010 decreased slightly, compared to the nine months ended September 30, 2009. Revenue from preneed property sales decreased slightly and preneed revenue from merchandise and services deliveries decreased $0.1 million. At-need revenues increased $0.1 million compared to the same period in 2009. As a percentage of revenues, cemetery acquired operating profit increased from 23.2% to 28.9% as we experienced a reduction of controllable expenses.

Total trust earnings increased $1.2 million, or 56.8%, when compared to the nine months ended September 30, 2009. Earnings from perpetual care trust funds totaled $3.0 million for the nine months ended September 30, 2010 compared to $1.8 million for the nine months ended September 30, 2009, due in large part to capital gains realized in the improving financial markets. Trust earnings recognized upon the delivery of merchandise and service contracts were flat compared to the same period in 2009.

Other. General and administrative expenses totaled $4.1 million for the three months ended September 30, 2010, an increase of $0.2 million compared to the three months ended September 30, 2009, due primarily to increases in acquisition transaction costs.

Income Taxes. The Company recorded income taxes at the estimated effective rate of 40.5% for 2009 and for the first nine months of 2010. For federal income tax reporting purposes, Carriage has net operating loss carryforwards totaling approximately $15.1 million available at September 30, 2010 to offset future Federal taxable income, which will expire between 2022 and 2028, if not utilized. Carriage also has approximately $62.2 million of state net operating loss carryforwards that will expire between 2010 and 2028, if not utilized. Based on management s assessment of the various state net operating losses, it has been 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. Accordingly, a valuation allowance was established and is reviewed every quarter related to the deferred tax asset related to the state operating losses.

LIQUIDITY AND CAPITAL RESOURCES

While the impact has not been dramatic yet, the adverse economic conditions in the U.S., particularly the high level of unemployment, will continue to affect our business. Carriage began 2010 with $3.6 million in cash and other liquid investments and ended the third quarter with $1.3 million in cash and $5.0 million drawn on the bank credit facility. The elements of cash flow for the nine months ended September 30, 2010 consisted of the following (in millions):

Cash and liquid investments at beginning of year	$ 3.6
Cash flow from operations	16.5
Business acquisitions	(16.8)
Cash drawn on the bank credit facility	5.0
Maintenance capital expenditures	(5.0)
Growth capital expenditures funeral homes	(0.2)
Growth capital expenditures cemeteries	(1.6)
Other investing and financing activities, net	(0.2)
Cash at September 30, 2010	$ 1.3

For the nine months ended September 30, 2010, cash provided by operating activities was $16.5 million as compared to $7.9 million for the nine months ended September 30, 2009. The 2009 period included the payment of a $3.3 million litigation settlement. Capital expenditures totaled $6.9 million for the nine months ended September 30, 2010 compared to $6.1 million for the nine months ended September 30, 2009. Capital expenditures for the first nine months of 2010 included $1.6 million for cemetery inventory development projects.

The outstanding principal of senior debt at September 30, 2010 totaled $141.8 million and consisted of $130.0 million in 7 % Senior Notes maturing in 2015, $5.0 million drawn on the credit facility and $6.8 million in acquisition indebtedness and capital lease obligations. Additionally, $0.1 million in letters of credit were issued and outstanding under the credit facility at September 30, 2010.

The Company has a $40.0 million senior secured revolving credit facility that matures in November 2012 and is collateralized by all personal property and funeral home real property in certain states. The credit facility also contains an accordion provision to borrow up to an additional $20.0 million. Borrowings under the credit facility bear interest at either prime or LIBOR options. At September 30, 2010, the prime rate option was equivalent to 5.75% and the LIBOR option was set at the 30 day LIBOR rate plus 350 basis points.

A total of $92.9 million was outstanding at September 30, 2010 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. In June 2010, the Company repurchased 17,850 shares of these TIDES for approximately $0.6 million and recorded a gain of $0.3 million. In September 2010, the Company converted these preferred shares at the current conversion rate of 2.4465 into shares of common stock equal to 43,670 shares. Immediately upon the exchange, these common shares were cancelled and held in Treasury.

The convertible junior subordinated debenture payable to the affiliated Trust, and the TIDES, each contain a provision for the deferral of interest payments and distributions for up to 20 consecutive quarters. During any 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%. During any deferral period, Carriage is prohibited from paying dividends on the Common Stock or repurchasing Common Stock, subject to limited exceptions. The Company currently expects to continue paying the distributions as due.

The Company intends to use its cash and credit facility primarily to acquire funeral home and cemetery businesses and for internal growth projects, such as cemetery inventory development. The Company has the ability to draw on our revolving credit facility, subject to customary terms and conditions of the credit agreement.

We believe our cash on hand, cash flow from operations, and the available capacity under our credit facility described above will be adequate to meet our working capital needs and other financial obligations over the next twelve months.

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.

Item 3. 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 fair market values related to outstanding debts and changes in the values of securities associated with the preneed and perpetual care trusts. For information regarding the Company s exposure to certain market risks, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk , in the Company s Annual Report filed on Form 10-K for the year ended December 31, 2009. There have been no significant changes in the Company s market risk from that disclosed in the Form 10-K for the year ended December 31, 2009.

The 7 % Senior Notes were issued to the public at par and are carried at a cost of $130 million. At September 30, 2010, these securities were typically trading at a price of approximately $99.25, indicating a fair market value of approximately $129 million.

The convertible junior subordinated debentures, payable to Carriage Services Capital Trust, pay interest at the fixed rate of 7% and are carried on our Consolidated Balance Sheets at a cost of approximately $92.9 million. The fair value of these securities is estimated to be approximately $56 million at September 30, 2010 based on available broker quotes of the corresponding preferred securities issued by the Trust.

Item 4. Controls and Procedures

In accordance with the Securities Exchange Act of 1934, as amended (the Exchange Act) Rules 13a-15 and 15d-15, we carried out an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2010 to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Our disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting that occurred during the nine months ended September 30, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

In addition to the matters in Note 11 to our Consolidated Financial Statements, we and our subsidiaries are parties to a number of legal proceedings that arise from time to time in the ordinary course of our business. We self-insure against certain risks and carry insurance with coverage and coverage limits for risk 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 and 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 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. [Removed and Reserved]

Item 5. Other Information

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

Item 6. Exhibits

11.1	Computation of Per Share Earnings
31.1	Certification of Periodic Financial Reports by Melvin C. Payne in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Periodic Financial Reports by Terry E. Sanford in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Periodic Financial Reports by Melvin C. Payne and Terry E. Sanford in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. Section 1350

SIGNATURE

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

	CARRIAGE SERVICES, INC.
Date: November 5, 2010	/s/ Terry E. Sanford Terry E. Sanford Executive Vice President and Chief Financial Officer

CARRIAGE SERVICES, INC.
INDEX OF EXHIBITS

11.1	Computation of Per Share Earnings
31.1	Certification of Periodic Financial Reports by Melvin C. Payne in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Periodic Financial Reports by Terry E. Sanford in satisfaction of Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Periodic Financial Reports by Melvin C. Payne and Terry E. Sanford in satisfaction of Section 906 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. Section 1350