2013
Annual Report

EXTENDICARE®

... helping people live better

Corporate Profile

Extendicare Inc. ("Extendicare" or the "Company") is a leading North American provider of post-acute and long-term senior care services. Through its network of owned and operated health care centers, the Company's qualified and experienced workforce of 35,300 individuals is dedicated to helping people live better through a commitment to quality service that includes skilled nursing care, rehabilitative therapies and home health care services. Extendicare's 249 senior care centers in Canada and the United States have capacity to care for approximately 27,700 residents.

Extendicare's common shares trade on the TSX under the symbol "EXE". Monthly cash dividends paid by the Company to its shareholders are at the discretion of its board of directors.

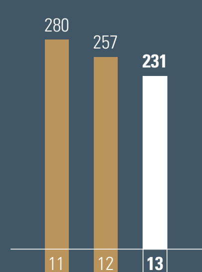
More information is available at **www.extendicare.com**.

Financial Highlights

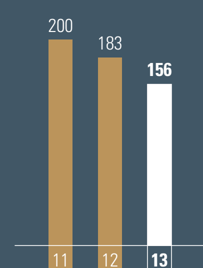
(millions of dollars unless otherwise noted)	**2013**	2012	2011
Balance Sheet			
Cash and short-term investments	**96.0**	71.4	80.0
Long-term debt, including current portion	**1,164.9**	1,132.2	1,134.4
Total assets	**1,849.1**	1,807.9	1,830.7
Shareholder Information(1)			
Funds from operations (FFO)	**66.8**	88.6	63.4
FFO *($ per basic share/unit)*	**0.77**	1.04	0.76
Adjusted funds from operations (AFFO)	**71.1**	84.6	69.8
AFFO *($ per basic share/unit)*	**0.82**	0.99	0.84
Distributions declared	**52.0**	71.5	70.1
Distributions declared *($ per basic share/unit)*	**0.60**	0.84	0.84
Weighed average shares/units – Basic *(thousands)*	**86,738**	85,039	83,408
– Fully diluted *(thousands)*	**103,708**	100,420	97,205

Revenue
(in billions of dollars)

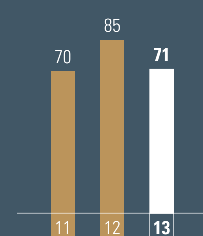
Net Operating Income(1)
(in millions of dollars)



EBITDA(1)
(in millions of dollars)



AFFO(1)
(in millions of dollars)



(1) Refer to non-GAAP measures on page 58.

Forward-looking Statements

Information provided by Extendicare from time to time, including this Annual Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to Extendicare and its subsidiaries, including, without limitation, statements regarding its business operations, business strategy and financial condition. Please refer to page 6 for a caution to the reader on the reliance of such statements.

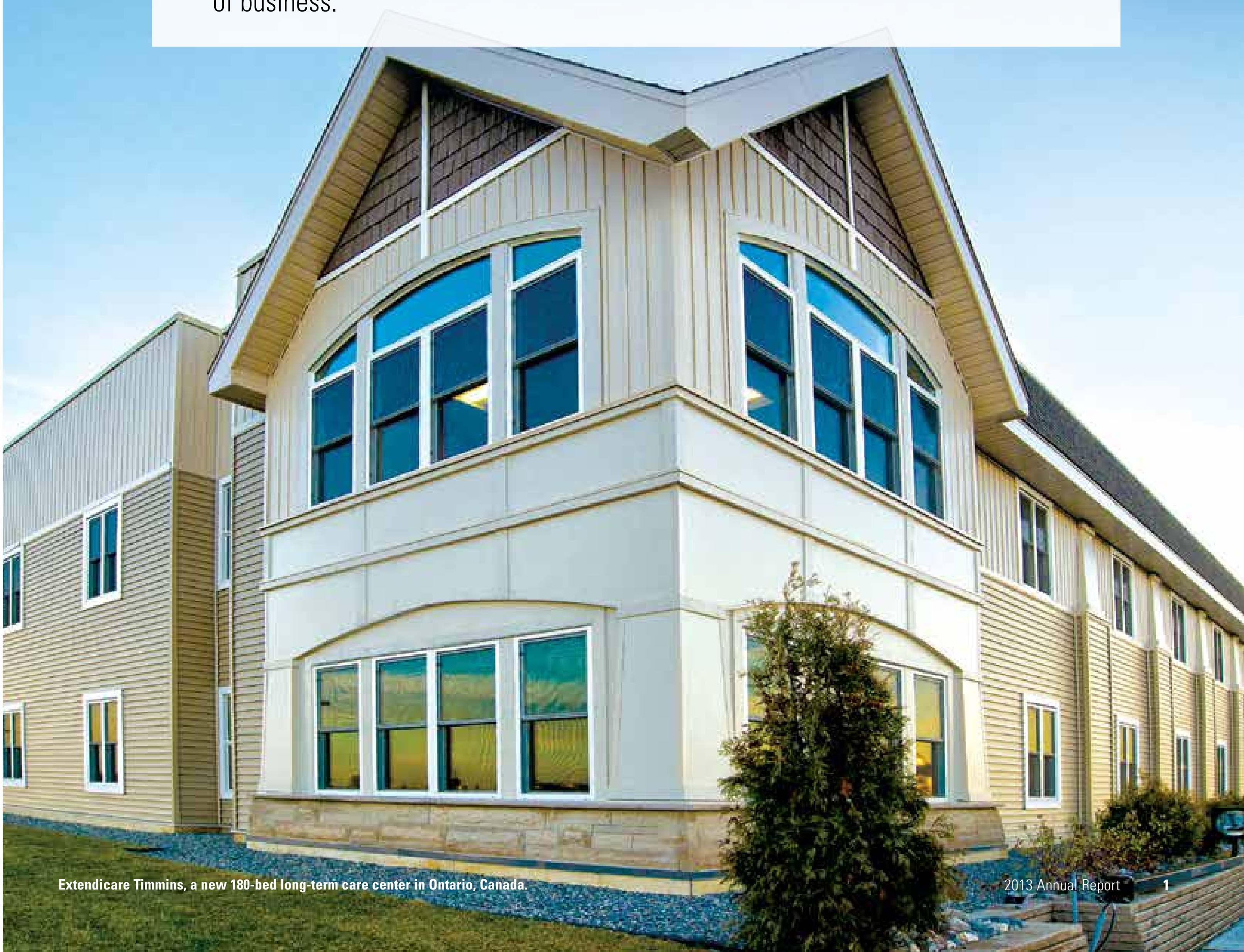
Contents

Cover: Extendicare Maple View of Sault Ste. Marie, a new 256-bed long-term care center in Ontario, Canada.

Investment Highlights

Extendicare generates strong cash flow and is well-positioned in an evolving health care environment to continue to be a leader in providing senior care services, due to:

- Strong demographic trends toward an aging population in North America, leading to increased demand for rehabilitative and long-term resident health care services.
- Successful operation of health care business, along with ownership of real estate assets, providing financial and operating flexibility and control.
- Long-term growth strategy enabled by property development experience, disciplined reinvestment programs, accretive acquisitions and expansion into ancillary lines of business.



Extendicare Timmins, a new 180-bed long-term care center in Ontario, Canada.

Extendicare Timmins is designed to create a home-like environment for its residents.

CEO's Message

Fellow Shareholders,

Extendicare is one of the largest post-acute providers in North America. Our goal is to provide stable long-term returns to our shareholders through the ownership and operation of skilled nursing, rehabilitation and related services. The foundation of our success lies in the delivery of quality care and customer service to our patients and residents. As the health care environment continues to evolve throughout both Canada and the United States, we strive to demonstrate our capabilities and build on our reputation for being a low-cost provider of high quality senior health care services in every market that we serve. In doing so, we are positioning our Company to be a valuable partner within the health care continuum. We believe, fundamentally, that our business success is dependent on the quality of the services we provide. These goals are mutually dependent as it is impossible to have one without the other. We are proud of our quality record and strive every day to continue to improve both our quality and financial performance.

U.S. Operations

Extendicare is the eighth largest operator of nursing center beds in the U.S. according to *Provider Magazine* (June 2013 edition). In 2013, our Company was again recognized for outstanding performance in the U.S. health care profession, winning six of the prestigious American Health Care Association's *Silver – Achievement in Quality* awards, and 13 of the *Bronze – Commitment to Quality* awards. With these 2013 awards, over 70% of our centers have received either bronze or silver awards from our national association. We are very proud of this accomplishment and thank our entire team at each of these centers for their constant dedication to achieving our mission of 'helping people live better'.

Extendicare's commitment to continuous quality improvement is also recognized through the Five-Star Quality Rating System, introduced by the U.S. Centers for Medicare and Medicaid Services to help consumers better select health care centers that meet their needs. Since its inception in 2009, we have improved our average overall star rating from 1.8 to 3.1 out of 5. Over the past three years, we have increased direct nursing care hours to meet the incremental demands related to high acuity patients. We believe we now have one of the highest star ratings for registered nurse hours of any of our peers in the U.S., demonstrating our commitment to quality care.

Canadian Operations

Extendicare's Canadian operations remain strong, with leadership positions in both the nursing center and home health care sectors in Canada. Extendicare is the largest private sector operator of long-term care centers in Canada. The majority of our operations are in Ontario, where we operate approximately 11% of the long-term care beds in the province, and provide approximately 15% of the publicly funded home health care hours of service. Our average daily revenue rate increased by 3.8% over 2012, and our occupancy rates remained unchanged at a solid 98%. In addition, our Ontario home health care volumes improved by 5.2% and we added six centers to our growing managed center portfolio.

On the development side, we continue to make strategic investments to grow our operations. During 2013, we completed new nursing centers in Sault Ste. Marie and Timmins, Ontario. These new centers replaced existing ones that we operated in those communities, and will improve both the quality of care and life of the residents.

Overall Financial Results

The past year was a challenging year for our Company from an overall financial perspective. Extendicare experienced disappointing financial results due to the persisting weakness in the U.S. economy, the impact of cuts to Medicare funding and changes to therapy services, and the need to strengthen our reserves for self-insured general and professional liabilities. For the year, Extendicare's revenue was $2,024.4 million, a decline of 2.5% over 2012 (excluding the positive impact of foreign exchange). This decline in revenue was mainly the result of our decision to exit operations in Kentucky by leasing these

At Extendicare, we believe, fundamentally, that our business success is dependent on the quality of the services we provide. We are proud of our quality record and strive every day to continue to improve both our quality and financial performance.

properties to a third party. Revenue from same-facility operations improved by $19.6 million, or 1.1%. Extendicare's Adjusted EBITDA was $155.7 million this year, and declined by 16.4% over 2012 (excluding the positive impact of foreign exchange), or by 15.2% on a same-facility basis. Our Adjusted EBITDA margin was 7.7% this year, compared to 9.0% in 2012, reflecting these challenges.

The results of the independent actuarial reviews completed during 2013 necessitated the continued strengthening of our reserves for self-insured liabilities. Compared to 2012, our provision increased by $13.7 million to $54.5 million this year, primarily due to prior years' reserves attributable to claims in the State of Kentucky and settlement of certain pre-2013 claims in other states.

Managing these claims is a key priority for us. We continue to pursue aggressive risk management strategies and devote significant resources to this issue so that we can effectively assess the validity of claims, mitigate liability and reduce our exposure to such claims in the future.

Strategic Review

As previously disclosed in May 2013, the board of directors of the Company, through its strategic committee, has been undertaking a review of strategic alternatives that would be in the best interests of the Company and would reasonably be expected to enhance shareholder value. With the assistance of a financial advisor, the Company has studied various alternatives extensively and analyzed relevant considerations, including valuation, taxation, curtailment of future liability costs, and strategic implications of each option.

At this time, we are negotiating with one party towards a transaction that may involve the lease and/or sale of some or all of our U.S. assets or business. Although substantial due diligence has been completed, there is no certainty that a transaction will be completed in the near term, if at all. Our intention is to de-risk relative to our U.S. business and position the Company to pursue opportunities to grow in Canada.

Future Outlook

Looking ahead, I am confident that Extendicare is well-positioned to succeed in the evolving health care environment. Our current challenges will make us a better and stronger organization as we move forward. As a result of the outcome of the strategic review process, we will embark on a more focused strategy and direction and chart a path towards continued success in the future.

I would like to thank each of our 35,300 team members across both countries and all divisions of the Company for their hard work and dedication on a daily basis. I'd also like to thank our customers for their loyalty, our shareholders for their support and our board of directors for their counsel.

Sincerely,

Timothy L. Lukenda
President & Chief Executive Officer
February 26, 2014

Mission, Vision, Values

Respect

Integrity

Pride

Compassion

Responsiveness

Dignity

Our Mission

We help people live better by providing quality, cost-effective health care and rehabilitation primarily to seniors in a resident-directed environment.

We accomplish this by providing remarkable services through highly engaged and motivated members of our team, resulting in an appropriate return to our investors.

Our Vision

Helping people live better, one life at a time, through our people, properties and technology.

People – our experienced and dedicated workforce help improve the quality of people's lives through a commitment to the highest standards of service to residents and their families who entrust us with their health care needs.

Properties – with a track record of over 45 years as an owner and operator of industry-leading North American senior care centers, we are at the forefront in design and excellence in quality care.

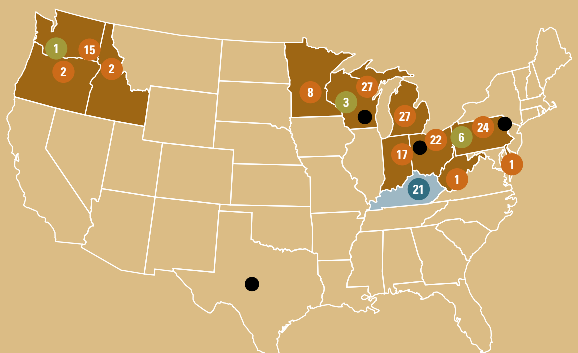
Technology – we incorporate technologies into the delivery of health care services to improve care and efficiency.

Our Values

At Extendicare, we value our customers and our team who cares for them. We are committed to treating them with dignity and respect in an atmosphere of compassion. As health care professionals, we take pride in being responsive to the needs of those who rely on us.

Operations Overview

U.S. Operations



- Nursing center operations
- Nursing center properties
- Assisted living & retirement centers
- ProStep outpatient rehab (23 clinics)

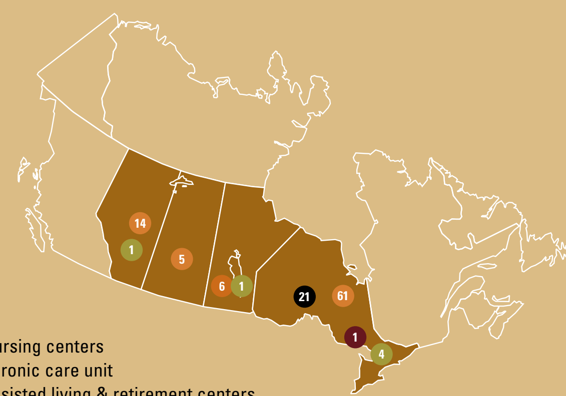
156	15,207	33%	50%
Centers operated in 11 states	**Beds**	**Quality mix census**	**Quality mix revenue**

- Revenue decreased by 5.7% to US$1,234.6 million in 2013 primarily due to the successful leasing out of our 21 skilled nursing centers in Kentucky to a third party in mid-2012; same-facility revenue declined by 0.5% due to lower census levels, partially offset by higher rates:
  - Medicare Part A rates increased by 1.9% to US$470
  - Managed Care rates increased by 2.5% to US$443
  - Weighted average of total rates increased by 3.8% to US$268
- AHCA/NCAL awards in 2013: six of our centers were awarded the *Silver – Achievement in Quality* award, and 13 were awarded the *Bronze – Commitment to Quality* award

Overview

Extendicare's U.S. operations are conducted through its wholly owned subsidiary, Extendicare Health Services, Inc. (EHSI). As a percentage of our consolidated results from continuing operations for 2013, approximately 62.8% of revenue and 53.8% of EBITDA was derived from our U.S. operations. EHSI is focused on providing quality, person-centered care to residents in their local communities. Over 70% of our U.S. senior care centers have been recognized for their commitment to quality by the American Health Care Association. The overall ranking of our U.S. skilled nursing centers under the Centers for Medicare & Medicaid Services' Five-Star Quality Rating System has improved from 1.8 in 2009 to 3.1 in 2013.

Canadian Operations



- Nursing centers
- Chronic care unit
- Assisted living & retirement centers
- ParaMed home health care (21 branches)

93	12,479	75%	98%
Centers operated in 4 provinces	**Beds**	**Resident capacity in Ontario**	**Occupancy**

- Revenue increased by 3.3% to $752.9 million primarily from funding increases and newly constructed centers, partially offset by reduced home health care volumes in Alberta
- Portfolio of managed centers increased by six to 35 during 2013
- Two new state-of-the-art centers opened in Ontario during 2013
  - 256-bed nursing center in Sault Ste. Marie (opened in April 2013)
  - 180-bed nursing center in Timmins (opened in October 2013)

Overview

Extendicare's Canadian operations are conducted through its wholly owned subsidiary, Extendicare (Canada) Inc. (ECI). As a percentage of our consolidated results from continuing operations for 2013, approximately 37.2% of revenue and 46.2% of EBITDA was derived from our Canadian operations. Our average same-facility occupancy levels remained consistently close to full capacity in 2013. We continue to upgrade our existing centers and to make strategic investments in communities to better serve the health care needs of local residents. Through ParaMed, we are the largest home health care operator in Ontario based on hours of service provided, and we expect that our superior quality service delivery will drive opportunities for future growth.

Financial Review

TABLE OF CONTENTS

Forward-looking Statements

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Although forward-looking statements are based upon estimates and assumptions that the Company believes are reasonable based upon information currently available, these statements are not representations or guarantees of future results, performance or achievements of the Company. In addition to the assumptions and other factors referred to specifically in connection with these forward-looking statements, factors that could cause the actual results, performance or achievements of Extendicare to differ materially from those expressed or implied by the forward-looking statements are identified in Extendicare's public filings with the Canadian securities regulators and include, without limitation, the following: changes in the overall health of the economy and government; the ability of the Company to attract and retain qualified personnel; changes in the health care industry in general and the long-term care industry in particular because of political and economic influences; changes in applicable accounting policies; changes in regulations governing the industry and the compliance by Extendicare and its subsidiaries with such regulations; changes in government funding levels for health care services; changes in tax laws; resident care and class action litigation, including the Company's exposure to punitive damage claims, increased insurance costs and other claims; the ability of Extendicare to maintain and increase census levels; changes in competition; changes in demographics and local environment economies; changes in foreign exchange and interest rates; changes in the financial markets that may affect the ability of Extendicare to refinance debt; and the availability and terms of capital to Extendicare to fund capital expenditures.

The forward-looking statements contained in this Annual Report are expressly qualified by this cautionary statement. Given these risks and uncertainties, readers are cautioned not to place undue reliance on the forward-looking statements of Extendicare. The forward-looking statements speak only as of the date of this Annual Report. Except as required by applicable securities laws, the Company assumes no obligations to update or revise any forward-looking statements.

February 26, 2014

BASIS OF PRESENTATION

Extendicare Inc. ("Extendicare" or the "Company") is the successor to Extendicare Real Estate Investment Trust ("Extendicare REIT" or the "REIT") following the conversion of the REIT from an income trust to a corporate structure pursuant to a plan of arrangement effective July 1, 2012 (the "2012 Conversion"). Extendicare's common shares (the "Common Shares") trade on the Toronto Stock Exchange (TSX) under the symbol "EXE".

The 2012 Conversion was accounted for by the Company as a continuity of interest, and accordingly, the consolidated financial statements of the Company are reflective as if the Company had always carried on the business previously carried on indirectly by Extendicare REIT. Comparative information for Extendicare relating to periods prior to the 2012 Conversion is that of its predecessor, Extendicare REIT.

Extendicare has prepared this Management's Discussion and Analysis (MD&A) to provide information to assist its current and prospective investors' understanding of the financial results for the year ended December 31, 2013. This MD&A should be read in conjunction with Extendicare's audited consolidated financial statements for the years ended 2013 and 2012, and the notes thereto, found in Extendicare's 2013 Annual Report. This material is available on Extendicare's website at www.extendicare.com. Additional information about Extendicare, including its latest Annual Information Form, can be found on SEDAR at www.sedar.com.

Extendicare is a leading North American provider of post-acute and long-term senior care services. Extendicare does not carry on business directly, but does so indirectly through its subsidiaries. This MD&A provides information on Extendicare and its subsidiaries, and unless the context otherwise requires, references to "Extendicare", the "Company", "we", "us" and "our" or similar terms refer to Extendicare Inc., either alone or together with its subsidiaries. The registered office of Extendicare is located at 3000 Steeles Avenue East, Markham, Ontario, Canada, L3R 9W2.

This MD&A and the accompanying audited consolidated financial statements for the years ended 2013 and 2012, including the notes thereto, have been prepared in accordance with International Financial Reporting Standards (IFRS). All dollar amounts are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2013, or December 31 of the year referenced.

The discussion and analysis in this MD&A is based upon information available to management as of February 26, 2014. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur, which could affect the Company in the future.

We use a number of key performance indicators in this document for monitoring and analyzing our financial results. These performance indicators are not defined by IFRS, and are therefore not considered to be generally accepted accounting principles, or GAAP, which may not be comparable to similar measures presented by other companies. Please refer to the "Key Performance Indicators" section of this MD&A. In addition, a discussion of the non-GAAP measures is provided under the heading "Accounting Policies and Estimates – Non-GAAP Measures".

OVERVIEW

Business Strategy

At Extendicare, our strategy is to create value for our shareholders through the effective operation and growth of our core senior care operations and complementary long-term care services. By emphasizing the quality of care provided to our residents and by clustering several long-term care centers together within the geographic areas served, our goal is to build upon our reputation as a leading provider of a full range of post-acute services in the community. In pursuing this strategy, an overriding objective is to continually enhance the quality of clinically based services provided to our residents and other clients. The key components of our value-creation strategy include:

- ensuring the continued delivery of quality care and customer service throughout our organization;
- establishing programs that enable our nursing centers to more efficiently attract higher acuity patients resulting in higher reimbursement rates;

- actively maintaining and improving our asset portfolio through a disciplined capital reinvestment program or, where appropriate, through disposition of underperforming or non-strategic centers;
- focusing on achieving operational efficiencies and internal growth in our core business and, when available, growth through new developments and value-creating acquisitions;
- ensuring the highest safety, quality and risk management practices throughout our operations;
- expanding non-government based revenue sources and diversifying within the long-term care industry through our rehabilitative services, information technology, management and consulting businesses;
- enhancing our Canadian businesses, including long-term care and home health care operations; and
- increasing funds from operations and adjusted funds from operations.

For the past several years, Extendicare has committed its resources to a "back-to-basics" strategy and the prudent stewardship of the management, growth and operations of its business. This commitment has been successful, particularly in the circumstances involving a weak U.S. economy and a challenging and uncertain regulatory environment.

We believe that Extendicare is a financially stable company with a conservative capital structure. The ownership of our real estate coupled with our geographic diversity position us favourably to address the numerous funding and regulatory challenges facing the industry.

Strategic Review

As previously disclosed in May 2013, the board of directors of the Company (the "Board"), through its strategic committee (the "Strategic Committee"), has been undertaking a review of strategic alternatives relating to a separation of the Company's Canadian and U.S. businesses that would be in the best interests of the Company and would reasonably be expected to enhance shareholder value. With the assistance of CitiGroup Global Markets Inc., as a financial advisor, the Company has studied various alternatives extensively and analyzed relevant considerations, including valuation, taxation, curtailment of future liability costs, and strategic implications of each option.

Extendicare confirms that the Strategic Committee continues its work on this initiative and that the Company is currently negotiating with one party towards a transaction that may involve the lease and/or sale of some or all of our U.S. assets or business. There is no certainty that a transaction will be completed in the near term, if at all. Material details will be disclosed to the public when available.

Business Overview

Extendicare, through its wholly owned subsidiary operating entities, is a major provider of short-term and long-term senior care services through its network of owned and operated health care centers in North America, operating 249 senior care centers with capacity for 27,686 residents at December 31, 2013. In addition to the 249 centers that we currently operate, we own 21 centers (1,762 beds) in the State of Kentucky that are leased to a third-party operator. The transfer of the Kentucky operations became effective July 1, 2012, for 19 of the centers and the remaining two centers were transferred effective October 1, 2012, as discussed under the heading "Other Significant Developments – 2012 Kentucky Lease Transaction".

Extendicare's wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates 156 senior care centers with capacity for 15,207 residents, and has a significant presence (more than 14% of its resident capacity) in each of Pennsylvania, Michigan, Wisconsin, and Ohio. EHSI offers a continuum of health care services, including nursing care, assisted living and related medical specialty services, such as post-acute care and rehabilitative therapy on an inpatient and outpatient basis.

Extendicare's wholly owned Canadian subsidiary, Extendicare (Canada) Inc. and its subsidiaries (collectively "ECI"), operates 93 senior care centers, with capacity for 12,479 residents. ECI has a significant presence in Ontario and Alberta, where approximately 75% and 13% of its residents are served, respectively. Also, through its ParaMed Home Health Care (ParaMed) division, ECI is the largest provider of publicly funded home health care in Ontario.

Extendicare owns rather than leases a majority of its properties, unlike a number of other long-term care providers. At December 31, 2013, we operated 201 centers that we either owned or leased with options to purchase, representing approximately 99% of our 204 owned or leased centers, excluding those operated under management contracts and the 21 Kentucky centers that have been leased to third-party operators.

We believe that ownership increases our operating flexibility by allowing us to: refurbish centers to meet changing consumer demands; expand or add assisted living and retirement centers adjacent to our nursing centers; adjust licensed capacity to avoid occupancy-based rate penalties; divest centers and exit markets at our discretion; and more directly control occupancy costs.

The following depicts ownership and management of senior care centers operated by EHSI and ECI at December 31, 2013. In addition, EHSI owns 21 centers (1,762 beds) in the State of Kentucky that are leased to a third-party operator.

	Nursing Centers		Assisted Living and Retirement Centers		Chronic Care Units		Total	
By Type of Ownership	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity	No. of Centers	Resident Capacity
United States								
Owned	138	13,960	4	270	–	–	142	14,230
Leased	4	419	–	–	–	–	4	419
Managed	4	399	6	159	–	–	10	558
Total U.S.	146	14,778	10	429	–	–	156	15,207
Canada								
Owned	48	6,688	1	200	–	–	49	6,888
Leased(1)	9	1,155	–	76	–	–	9	1,231
Managed	29	3,752	5	488	1	120	35	4,360
Total Canada	86	11,595	6	764	1	120	93	12,479
Total	**232**	**26,373**	**16**	**1,193**	**1**	**120**	**249**	**27,686**

(1) The nine leased centers in Canada are operated under 25-year finance lease arrangements maturing beginning in 2026 through to 2028.

The following reflects the change in operating capacity of our senior care centers during 2013 and 2012.

	2013		2012	
Extendicare Senior Care Centers	**No. of Centers**	**Operational Beds/Units**	No. of Centers	Operational Beds/Units
As at beginning of year	**246**	**26,828**	261	28,107
Developed(1)	**2**	**436**	–	–
Closed(1)	**(4)**	**(412)**	–	–
Managed contracts added	**8**	**1,338**	6	738
Managed contracts matured	**(3)**	**(425)**	–	–
Conversion of assisted living wing to skilled nursing center beds(2)	**–**	**30**	–	(35)
Divested/leased to third party(3)	**–**	**–**	(21)	(1,762)
Operational capacity adjustments(4)	**–**	**(109)**	–	(220)
As at end of year	**249**	**27,686**	246	26,828

(1) In April 2013, we opened a new 256-bed nursing center in Sault Ste. Marie and closed two existing nursing centers (215 beds) and transferred 50 beds from another center in the area. In September 2013, we closed the rehabilitation hospital in Michigan (28 beds). In October 2013, we opened a new 180-bed nursing center in Timmins and closed an existing nursing center (119 beds).

(2) We closed an assisted living wing of a skilled nursing center in the 2012 fourth quarter and converted it to skilled nursing beds at the beginning of 2013.

(3) The 2012 activity relates to the Kentucky lease transaction, as discussed under the heading "Other Significant Developments – 2012 Kentucky Lease Transaction".

(4) The reduction in operational capacity was due primarily to U.S. beds removed from service in order to either increase our Medicaid rate or to accommodate rehabilitation suites.

Significant 2013 Events and Developments

This section summarizes the impact of the following items on the operations of Extendicare: the Medicare update; the 2013 U.S. PrivateBank loan refinancing; the 2013/2014 Canadian mortgage refinancings; and legal proceedings and regulatory actions. Refer to the discussion under the heading "Other Significant Developments" for a summary of other developments affecting the financial results or operations of Extendicare.

MEDICARE UPDATE

The U.S. Centers for Medicare & Medicaid Services (CMS) implemented a net market basket increase on October 1, 2013, of 1.3%, consisting of a market basket increase of 2.3% minus a forecasting error of 0.5% and a productivity adjustment of 0.5%. We estimate that the impact of this funding increase will provide us with additional Medicare Part A and Managed Care revenue of approximately US$5.1 million per annum.

As previously reported, the Special U.S. Joint Select Committee on Deficit Reduction failed to make a recommendation to reduce government spending by January 15, 2012, and the long-term care industry was facing automatic Medicare funding reductions of 2% effective January 2, 2013, as a result of sequestration. These cuts were delayed until April 1, 2013, by the signing into law of the *American Taxpayer Relief Act of 2012* (ATRA). The 2% funding reduction effective April 1, 2013, is estimated to reduce our Medicare and Managed Care revenue by approximately US$6.3 million per annum. Sequestration will remain in effect through to 2023, unless there are future legislative changes.

Effective October 2012, CMS established a new medical review process for annual claims over US$3,700 for physical and speech therapy and a second medical review process for annual claims over US$3,700 for occupational therapy. The ATRA extended this review process until December 31, 2013, and the *Pathway for SGR Reform Act of 2013* (the "SGR Act"), enacted into law on December 26, 2013, further extended these requirements until March 31, 2014. EHSI has recorded negative revenue adjustments of US$1.0 million and US$2.3 million in 2012 and 2013, respectively, for denials of therapy services related to this medical review process.

The ATRA also implemented a reduction in the reimbursement for Medicare Part B services due to an increase in the multiple procedure payment reduction (MPPR) percentage from 25% to 50%, effective April 1, 2013. EHSI estimates that this reduction will reduce its annual therapy revenue by approximately US$3.6 million.

The SGR Act postpones an estimated 27% cut to the Medicare Physician Fee Schedule (MPFS) rates through March 31, 2014. Passage of this short-term extension, often referred to as the "Doc Fix", averts cuts to Part B therapy rates received by EHSI amounting to approximately US$11 million per annum. Proposals for a more permanent solution are currently pending.

For a discussion of recent Medicare and Medicaid funding changes, and other factors affecting the outlook for future funding, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

2013 U.S. PRIVATEBANK LOAN REFINANCING

In April 2013, EHSI closed on six mortgages insured with the U.S. Department of Housing and Urban Development Program (HUD) totalling US$37.7 million with a weighted average interest rate of 3.66%, inclusive of mortgage insurance premiums (MIP) of 0.65%, and a weighted average term to maturity of approximately 32 years. The proceeds were used to repay our PrivateBank loans, which had an aggregate principal balance of US$33.8 million as at March 31, 2013. A loss of $0.4 million (US$0.4 million) in connection with the early retirement of this debt was recorded in the 2013 second quarter.

2013/2014 CANADIAN MORTGAGE REFINANCINGS

Effective August 1, 2013, ECI renewed its existing $15.4 million Canada Mortgage and Housing Corporation (CMHC) mortgage on three Ontario nursing centers for a term of five years at a fixed rate of 3.08%.

Effective September 5, 2013, ECI refinanced three Manitoba nursing centers with conventional mortgages totalling $26.0 million at a fixed rate of 4.14% for a term of seven years. The existing mortgages had a balance of $15.3 million at June 30, 2013, maturing November 2013. A loss of $0.2 million in connection with the early retirement of this debt was recorded in the 2013 third quarter.

In January 2014, ECI committed to the renewal of its existing $6.4 million CMHC mortgage on an Ontario nursing center for a term of 10 years at a fixed rate of 3.62%, effective March 1, 2014.

LEGAL PROCEEDINGS AND REGULATORY ACTIONS

The provision of health care services is subject to complex federal, state and provincial laws and regulations, including laws and regulations that are intended to prevent health care fraud and abuse. Extendicare and its consolidated subsidiaries are defendants in various actions and proceedings that are brought against them from time to time in connection with their operations. Recently adopted U.S. health care reform legislation has resulted in an increase in government oversight of the long-term care industry and, as a result, long-term care providers, including Extendicare, are experiencing an increase in government surveys, investigations, audits and scrutiny of their operations. In such circumstances, Extendicare cooperates in responding to information requests and takes the necessary corrective actions. Extendicare accrues for costs that may result from investigations to the extent that an outflow of funds is probable and a reliable estimate of the amount of the associated costs can be made.

As a result of any determination that Extendicare has violated the U.S. Social Security Act or other applicable laws and regulations in connection with a government investigation or otherwise, or in connection with any settlement of an allegation of the same, Extendicare may incur significant costs, fines, civil monetary penalties, recoupments and administrative penalties (including suspension or exclusion from participation in Medicare, Medicaid and other provider programs) and suffer other sanctions. Among other things, as part of the settlement of any investigation or as a result of litigation relating to an investigation, the Company may be required to assume specific procedural and financial obligations under a corporate integrity agreement, which would typically require the Company to retain a third-party monitor and to implement various new reporting and employee training requirements, and/or other arrangement with the government. Any of these outcomes could have a material adverse effect on the business, results of operations and consolidated financial position of Extendicare.

As previously disclosed, EHSI has received subpoenas from the U.S. Department of Health and Human Services, Office of the Inspector General (OIG) relating to the submission of claims that the OIG believes may be in violation of the U.S. Social Security Act. Starting in November 2012, representatives of the OIG and the U.S. Department of Justice (DOJ) have been meeting with senior representatives of EHSI to discuss the OIG's and DOJ's investigations into the submission of claims that relate to the quality of care provided to residents and patients of EHSI's skilled nursing centers and the provision of rehabilitation services. EHSI has continued to work cooperatively with the OIG and DOJ and settlement discussions between EHSI and the OIG and DOJ have been ongoing with a view to resolving the investigations on a nationwide basis. The settlement discussions include the requirement that EHSI enter into a corporate integrity agreement with the OIG, the principal terms and conditions of which have not been agreed to. If EHSI enters into a corporate integrity agreement or incurs any fines, penalties or recoupment as part of a settlement of the OIG and DOJ investigations described above, it would not be an admission by EHSI that EHSI or any of its subsidiaries provided substandard patient care or medically unnecessary rehabilitation services. As at February 26, 2014, settlement discussions between the OIG and DOJ and EHSI and its outside counsel were not sufficiently advanced for EHSI to be able to predict the possible outcomes of the investigations (or any possible related litigation if a settlement with the OIG and DOJ is not reached) and the Company is unable to reliably estimate the range or the amount of the associated costs or loss that may be incurred. Any settlement or the outcome of any related litigation could involve the payment of substantial sums and other sanctions that could have a material adverse effect on the Company's business, results of operations or consolidated financial position. EHSI believes that it is in material compliance with the U.S. Social Security Act and other applicable federal and state laws and regulations. EHSI's nursing centers are subject to periodic unannounced federally mandated inspections by state or federal authorities to determine compliance by the centers with applicable health care laws and regulations. Every effort is made by EHSI to avoid or mitigate deficiencies through quality assurance strategies and to remedy any deficiencies cited by the inspections within the prescribed time period.

KEY PERFORMANCE INDICATORS

In order to compare Extendicare's financial performance between periods, management assesses the key performance indicators for all of its continuing operations. In addition, we assess the operations on a same-facility basis between the reported periods. Set forth below is an analysis of the key performance indicators and a discussion of significant trends when comparing Extendicare's financial results.

The following is a glossary of terms for some of our key performance indicators:

"ADC" means average daily census, and is the number of residents occupying a bed over a period of time, divided by the number of days in that period;

"Average Daily Revenue Rate", or **"ADRR"** means the aggregate revenue earned divided by the aggregate census in the corresponding period, by payor source;

"Census" is defined as the number of residents occupying beds (or units in the case of an assisted living center) over a period of time;

"CI" means commercial insurance, which is a form of health care coverage in the United States;

"CMI" means case mix index, which is a measure of the relative cost or resources needed to treat the mix of patients or residents;

"HMO" means health maintenance organization, which is a type of managed care organization that provides a form of health care coverage in the United States;

"Managed Care" refers collectively to HMO and CI payor sources, but does not include HMOs serving Medicaid residents, which are included in the Medicaid category;

"Non same-facility", in the context of comparing our 2013 and 2012 operations in this document, refers to (i) those centers and businesses that we have ceased operating (including those under a sale agreement), (ii) those centers that are new to our portfolio, since January 1, 2012, and (iii) those centers that are classified as held for sale. For the purposes of comparing our 2013 and 2012 results, the U.S. non same-facility operations is composed of: our 21 skilled nursing centers in the State of Kentucky that were leased out in the latter half of 2012; our rehabilitation hospital in the State of Michigan that was closed at the end of September 2013; and 11 skilled nursing centers that are held for sale. The Canadian non same-facility operations is composed of: our nursing center operations in Sault Ste. Marie and Timmins, Ontario, where we opened two new nursing centers in 2013 that resulted in the closing of three existing centers and the downsizing of another; and our Alberta home health care operations, where we discontinued operating in August 2013;

"Occupancy" is measured as the percentage of census relative to the total available resident capacity. Total operational resident capacity is the number of beds (or units in the case of an assisted living center) available for occupancy multiplied by the number of days in the period;

"Quality Mix" is the measure of the level of non-Medicaid payor sources. In most states, Medicaid is the least attractive payor source as rates are the lowest among all payor types;

"Same-facility", in the context of comparing our 2013 and 2012 operations in this document, refers to those centers and businesses that were operated by us on January 1, 2012, and throughout 2012 and 2013, and are not classified as held for sale; and

"Skilled Mix" refers collectively to Medicare and Managed Care payor sources. These sources generally include residents with short-term rehabilitative needs that we focus on accommodating.

U.S. Operations

We have established clinical programs designed to enable our centers to accommodate higher acuity residents and those requiring rehabilitative care and services. These residents are primarily admitted into our centers with Medicare and Managed Care as their primary funding source. Approximately 43% of our Managed Care residents have rates that are based on the Resource Utilization Groupings (RUGs) classification system, or are partially aligned with the Medicare rates. Medicaid rates are generally lower than rates earned from other sources. Therefore, we consider Skilled Mix to be an important performance measurement indicator. Although higher acuity residents generally produce higher revenue per resident day, profitability may be impacted by the costs associated with the increased resources needed to accommodate the needs of these residents. Additionally, these residents usually have a significantly shorter length of stay. During 2013, approximately 83% (2012 – 82%) of our admissions were Medicare or Managed Care funded, with 49% (2012 – 51%) funded by Medicare and 34% (2012 – 31%) funded by Managed Care.

Through the establishment of specific clinical programs that we market to high-acuity residents who are admitted to our centers to recover from neurological conditions, cardiovascular ailments, joint replacements and other disorders requiring intensive therapy, our revenue is increased. We are also able to return these residents to lower-cost settings faster. The funding source for most of these residents is Medicare or Managed Care. Individuals who do not qualify for a funded program pay for the services directly. Therefore, we focus on these payor types to increase average daily revenue rates and improve Quality Mix census as a percentage of the total ADC. After the short-term rehabilitative portion of a resident's stay, residents who require further longer-term care and who do not have the financial means to pay for it, seek funding from state Medicaid programs at rates that are generally lower than those earned from other sources.

Our data collection and reporting system allows us to electronically track the condition of the residents and services provided for them. This electronic system enables us to operate more efficiently within the RUGs classifications system, by ensuring that appropriate payment is received for services being delivered and, thereby, increasing our average Medicare rates.

SKILLED NURSING CENTER REVENUE BY PAYOR SOURCE

The CMS Medicare net market basket increases for October 1, 2012 and 2013, were 1.8% and 1.3%, respectively. However, our Medicare Part A and Managed Care rates were adversely impacted by the sequestration funding reduction of 2.0% effective April 1, 2013 and our Medicare Part A funding has been impacted by a reduction in co-insurance reimbursement for bad debts, which declined from 100% to 88% on January 1, 2013, and to 76% on January 1, 2014. For the 2013 fourth quarter, our average daily Medicare Part A rate, excluding prior period settlement adjustments, was US$468.78, representing a decrease of 0.3% from US$470.21 in the 2012 fourth quarter, primarily due to the impact of sequestration partially offset by the market basket increase. In comparison to our average daily Medicare Part A rate of US$471.20 in the 2013 third quarter, our rate this quarter declined by 0.5%, primarily due to the reduction in reimbursement for bad debts and a change in acuity mix, partially offset by the net market basket increase. For 2013 compared to 2012, our average daily Medicare Part A rate increased by 1.9% to US$470.21, primarily due to changes in acuity mix, with the impact of the market basket increases being substantially offset by sequestration and reductions in reimbursement for bad debts.

For the 2013 fourth quarter, our average daily Managed Care rate, excluding prior period settlement adjustments, was US$445.03, representing an increase of 1.3% from US$439.41 in the 2012 fourth quarter and a 0.8% decline from US$448.82 in the 2013 third quarter, primarily due to changes in acuity mix. For 2013, our average daily Managed Care rate increased by 2.5% to US$443.27.

Our average daily Medicaid rate, excluding prior period settlement adjustments, increased this quarter by 3.5% to US$200.80 from US$194.03 in the 2012 fourth quarter, and by 0.5% from US$199.76 in the 2013 third quarter. For 2013 compared to 2012, our average daily Medicaid rate increased by 5.4% to US$199.07. However, revenue from Medicaid rate increases was partially offset by higher state provider taxes, resulting in a net increase of 5.0% this year over 2012. In addition, during the 2012 fourth quarter, we became eligible to receive Upper Payment Limit funding for all of our centers in Indiana. Exclusive of this additional funding, the net increase in Medicaid rates this year over 2012 was 3.2%. For the majority of the states in which we operate, Medicaid funding changes take effect in July and October.

The following table provides the percentage of EHSI's revenue by payor source and the average revenue rates for its total skilled nursing center operations, excluding prior period settlement adjustments, on a quarterly and annual basis for each of 2013 and 2012.

	Q1		Q2		Q3		Q4		Year	
(total operations)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Revenue by Payor Source *(%)*										
Medicare	**32.0**	31.9	**29.9**	31.7	**28.8**	30.5	**28.3**	29.7	**29.7**	31.0
Managed Care	**10.9**	10.2	**10.7**	9.6	**10.7**	10.2	**10.8**	10.3	**10.7**	10.1
Skilled Mix	**42.9**	42.1	**40.6**	41.3	**39.5**	40.7	**39.1**	40.0	**40.4**	41.1
Private/other	**8.9**	8.8	**9.6**	9.0	**9.7**	9.4	**10.0**	9.7	**9.6**	9.2
Quality Mix	**51.8**	50.9	**50.2**	50.3	**49.2**	50.1	**49.1**	49.7	**50.0**	50.3
Medicaid	**48.2**	49.1	**49.8**	49.7	**50.8**	49.9	**50.9**	50.3	**50.0**	49.7
Total	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Average Revenue Rate by Payor Source *(US$)*										
Medicare Part A	**476.08**	456.29	**464.30**	455.25	**471.20**	466.23	**468.78**	470.21	**470.21**	461.45
Medicare Parts A and B	**516.86**	504.91	**504.22**	502.54	**517.06**	519.37	**508.95**	510.68	**511.84**	508.92
Managed Care	**439.44**	426.07	**440.04**	430.66	**448.82**	434.35	**445.03**	439.41	**443.27**	432.38
Private/other	**245.04**	232.15	**244.29**	236.02	**241.26**	237.80	**247.79**	235.69	**244.60**	235.39
Medicaid	**195.39**	185.00	**197.14**	186.83	**199.76**	190.42	**200.80**	194.03	**199.07**	188.87
Weighted average	**270.56**	256.19	**266.26**	256.75	**267.29**	260.47	**267.51**	261.78	**268.44**	258.66

The following table provides the percentage of EHSI's revenue by payor source from its same-facility skilled nursing center operations, excluding prior period settlement adjustments, on a quarterly and annual basis for each of 2013 and 2012.

	Q1		Q2		Q3		Q4		Year	
(same-facility operations)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Revenue by Payor Source *(%)*										
Medicare	**32.2**	32.2	**30.0**	32.3	**29.0**	30.9	**28.6**	29.9	**29.9**	31.3
Managed Care	**10.9**	10.9	**10.8**	10.3	**10.8**	10.3	**10.9**	10.3	**10.8**	10.5
Skilled Mix	**43.1**	43.1	**40.8**	42.6	**39.8**	41.2	**39.5**	40.2	**40.7**	41.8
Private/other	**8.9**	8.9	**9.6**	9.1	**9.5**	9.3	**10.0**	9.6	**9.5**	9.2
Quality Mix	**52.0**	52.0	**50.4**	51.7	**49.3**	50.5	**49.5**	49.8	**50.2**	51.0
Medicaid	**48.0**	48.0	**49.6**	48.3	**50.7**	49.5	**50.5**	50.2	**49.8**	49.0
Total	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0

On a same-facility basis, the percentage of our Skilled Mix revenue to total revenue declined to 39.5% from 40.2% in the 2012 fourth quarter, and declined from 39.8% in the 2013 third quarter. These declines were primarily due to declines in Skilled Mix census as discussed in the following section. For 2013, our same-facility Skilled Mix revenue represented 40.7% of total revenue compared to 41.8% in 2012. This decline was primarily due to a decline in Skilled Mix census as discussed in the following section, partially offset by the impact of the change in acuity mix on our average rates as discussed above.

On a same-facility basis, the percentage of Medicare residents receiving therapy services declined to 85.9% in the 2013 fourth quarter from 86.5% in the 2012 fourth quarter and from 86.8% in the 2013 third quarter. For 2013, this percentage improved to 86.5% from 85.8% in 2012.

For more information on Medicare and Medicaid funding in the U.S., including recent developments and their impact or expected impact on Extendicare, please see "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

SKILLED NURSING CENTER AVERAGE DAILY CENSUS

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers from total operations, on a quarterly and annual basis for each of 2013 and 2012.

	Q1		Q2		Q3		Q4		Year	
(total operations)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Average Daily Census										
Medicare	**2,055**	2,283	**1,887**	2,263	**1,765**	1,918	**1,767**	1,864	**1,868**	2,081
Managed Care	**821**	861	**770**	804	**756**	768	**770**	748	**779**	795
Skilled Mix	**2,876**	3,144	**2,657**	3,067	**2,521**	2,686	**2,537**	2,612	**2,647**	2,876
Private/other	**1,209**	1,365	**1,256**	1,366	**1,271**	1,287	**1,289**	1,321	**1,256**	1,334
Quality Mix	**4,085**	4,509	**3,913**	4,433	**3,792**	3,973	**3,826**	3,933	**3,903**	4,210
Medicaid	**8,169**	9,568	**8,035**	9,551	**8,070**	8,578	**8,064**	8,302	**8,084**	8,997
Total	**12,254**	14,077	**11,948**	13,984	**11,862**	12,551	**11,890**	12,235	**11,987**	13,207
Census by Payor Type *(%)*										
Medicare	**16.8**	16.2	**15.8**	16.2	**14.9**	15.3	**14.9**	15.2	**15.6**	15.8
Managed Care	**6.7**	6.1	**6.4**	5.7	**6.4**	6.1	**6.5**	6.1	**6.5**	6.0
Skilled Mix	**23.5**	22.3	**22.2**	21.9	**21.3**	21.4	**21.4**	21.3	**22.1**	21.8
Private/other	**9.8**	9.7	**10.6**	9.8	**10.7**	10.3	**10.8**	10.8	**10.5**	10.1
Quality Mix	**33.3**	32.0	**32.8**	31.7	**32.0**	31.7	**32.2**	32.1	**32.6**	31.9
Medicaid	**66.7**	68.0	**67.2**	68.3	**68.0**	68.3	**67.8**	67.9	**67.4**	68.1
Total	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Average occupancy *(%)*	**84.6**	85.9	**82.6**	85.6	**81.8**	84.9	**82.5**	84.2	**82.9**	85.2

In the latter half of 2012, we transferred our Kentucky operations (21 centers and 1,762 beds) to a third-party operator. Nineteen of the centers were transferred on July 1, 2012 and the remaining two were transferred effective October 1, 2012. This transaction accounts for the majority of the declines in ADC from total operations when comparing ADC in 2013 to quarters prior to the 2012 third quarter.

We continue to be adversely affected by the weak U.S. economic conditions that have reduced disposable income of individuals and resulted in a general restraint by the public on health care spending. Lower hospital census has resulted in fewer admissions, and the implementation of MDS 3.0 and RUG-IV as of October 2010 has also resulted in a small reduction in our average length of stay for short-term admissions. In addition, certain state Medicaid programs are attempting to divert potential admissions to assisted living centers and home care programs to reduce the strain on Medicaid budgets.

We have implemented a number of short-term and longer-term tactics, which take a more strategic approach to identifying and meeting the program and service needs of each community in which we are located. Included in these initiatives is the establishment of Active Life Transition Units (ALTUs) that are upgraded suites targeted to attract our short-term rehabilitation residents. We have completed 17 ALTUs and currently have two additional ALTUs under construction. We plan to continue to expand the number of centers with ALTUs.

EHSI's total skilled nursing center ADC declined by 2.8%, or 345 ADC, to 11,890 in the 2013 fourth quarter from 12,235 in the 2012 fourth quarter. Our same-facility operations contributed lower ADC of 324, and the balance of the decline in ADC of 21 related to our non same-facility operations. Our average occupancy in the 2013 fourth quarter was 82.5% compared to 84.2% in the 2012 fourth quarter and 81.8% in the 2013 third quarter. For 2013, our total skilled nursing center ADC declined by 9.2%, or 1,220 ADC to 11,987 from 13,207 in 2012. Our same-facility operations contributed lower ADC of 317, and the balance of the decline in ADC of 903 related to our non same-facility operations, primarily due to the leasing out of our Kentucky operations in 2012. Our average occupancy from total skilled nursing center operations in 2013 was 82.9% compared to 85.2% in 2012.

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers from same-facility operations, on a quarterly and annual basis for each of 2013 and 2012.

	Q1		Q2		Q3		Q4		Year	
(same-facility operations)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Average Daily Census										
Medicare	**1,961**	1,928	**1,800**	1,941	**1,686**	1,822	**1,696**	1,778	**1,785**	1,867
Managed Care	**778**	776	**737**	728	**722**	723	**735**	705	**743**	733
Skilled Mix	**2,739**	2,704	**2,537**	2,669	**2,408**	2,545	**2,431**	2,483	**2,528**	2,600
Private/other	**1,148**	1,150	**1,193**	1,167	**1,196**	1,193	**1,218**	1,235	**1,189**	1,186
Quality Mix	**3,887**	3,854	**3,730**	3,836	**3,604**	3,738	**3,649**	3,718	**3,717**	3,786
Medicaid	**7,654**	7,809	**7,529**	7,781	**7,560**	7,888	**7,543**	7,798	**7,571**	7,819
Total	**11,541**	11,663	**11,259**	11,617	**11,164**	11,626	**11,192**	11,516	**11,288**	11,605
Census by Payor Type *(%)*										
Medicare	**17.0**	16.5	**16.0**	16.7	**15.1**	15.7	**15.2**	15.5	**15.8**	16.1
Managed Care	**6.7**	6.7	**6.5**	6.3	**6.5**	6.2	**6.5**	6.1	**6.6**	6.3
Skilled Mix	**23.7**	23.2	**22.5**	23.0	**21.6**	21.9	**21.7**	21.6	**22.4**	22.4
Private/other	**10.0**	9.8	**10.6**	10.0	**10.7**	10.3	**10.9**	10.7	**10.5**	10.2
Quality Mix	**33.7**	33.0	**33.1**	33.0	**32.3**	32.2	**32.6**	32.3	**32.9**	32.6
Medicaid	**66.3**	67.0	**66.9**	67.0	**67.7**	67.8	**67.4**	67.7	**67.1**	67.4
Total	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Average occupancy *(%)*	**85.5**	85.6	**83.5**	85.5	**82.8**	85.6	**83.4**	85.1	**83.8**	85.5

Our same-facility skilled nursing center ADC of 11,192 in the 2013 fourth quarter was 324 below the 2012 fourth quarter level of 11,516 due to lower Medicaid ADC of 255, lower Skilled Mix ADC of 52, and lower private/other ADC of 17. In comparison to the 2013 third quarter, our same-facility ADC improved by 28 due to higher Skilled Mix ADC of 23 and higher private/other ADC of 22, partially offset by lower Medicaid ADC of 17. Our average same-facility occupancy was 83.4% this quarter compared to 85.1% in the 2012 fourth quarter, and 82.8% in the 2013 third quarter. For 2013, our same-facility skilled nursing center ADC declined by 2.7%, or 317 ADC to 11,288 from 11,605 in 2012 due to lower Skilled Mix ADC of 72 and lower Medicaid ADC of 248, partially offset by higher private/other ADC of three. Our average occupancy from same-facility skilled nursing center operations in 2013 was 83.8% compared to 85.5% in 2012.

Our same-facility Skilled Mix ADC of 21.7% of our residents in the 2013 fourth quarter improved over 21.6% in each of the 2012 fourth and 2013 third quarters, and was unchanged at 22.4% in each of 2013 and 2012.

Canadian Operations

The funding received by ECI for its nursing centers and home health care services is regulated by provincial authorities (rather than federal authorities), who often set the rates following consultation with the providers and their industry associations. This type of system reduces the potential for a single change or event to significantly affect the reimbursement or regulatory environment for ECI. For more information on government funding in Canada, including recent developments and their impact or expected impact on Extendicare, please see "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada".

The following table provides ECI's average daily revenue rates and occupancy levels from its total nursing and assisted living center operations, on a quarterly and annual basis for each of 2013 and 2012.

	Q1		Q2		Q3		Q4		Year	
(total operations)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Average revenue rate *($)*	**191.12**	183.92	**192.39**	187.57	**191.86**	186.26	**201.82**	191.15	**194.33**	187.24
Average occupancy *(%)*	**97.5**	97.4	**97.6**	97.8	**98.0**	97.9	**97.8**	98.7	**97.7**	98.0

The following table provides ECI's average daily revenue rates and occupancy levels from its same-facility nursing and assisted living operations, on a quarterly and annual basis for each of 2013 and 2012.

	Q1		Q2		Q3		Q4		Year	
(same-facility operations)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Average revenue rate *($)*	**191.67**	184.69	**192.47**	188.13	**192.19**	186.77	**201.20**	191.80	**194.41**	187.86
Average occupancy *(%)*	**97.5**	97.3	**97.6**	97.7	**98.0**	97.9	**98.2**	98.7	**97.8**	97.9

Revenue from provincial programs represented approximately 68% of ECI's nursing center revenue in 2013 (2012 – 66%). ECI's average daily revenue rate increased by 5.6% to $201.82 in the 2013 fourth quarter from $191.15 in the 2012 fourth quarter, and by 5.2% from $191.86 in the 2013 third quarter. The majority of ECI's nursing center operations are in Ontario, which operates under a funding envelope system, under which a substantial portion of the revenue is tied to flow-through funding. Therefore, the flow-through funding is matched with the related costs for resident care in the periods in which the costs are incurred. As a result, ECI's average revenue rates fluctuate by quarter, and are generally at their lowest in the first quarter and at their highest in the fourth quarter. For 2013, the average daily revenue rate increased by 3.8% to $194.33 from $187.24, and on a same-facility basis it increased by 3.5% to $194.41.

Historically, the supply of long-term care beds in Canada has been very restricted in comparison to the United States. As a result, nursing center operators in Canada typically enjoy higher occupancy levels than those in the United States. Our average occupancy in Canada was 97.7% in 2013 compared to 98.0% in 2012, with the majority of the decline resulting from the fill-up period associated with the opening of a new larger nursing center in Timmins, Ontario this past fall. On a same-facility basis, our average occupancy was relatively unchanged at 97.8% in 2013 compared to 97.9% in 2012. In terms of the quarterly trends throughout the year, slightly lower occupancy levels are to be expected during the winter months as a result of flu outbreaks, which can lead to temporary freezes on admissions.

With respect to our Canadian home health care operations, effective August 2013, ParaMed no longer provides services in Alberta as a result of the outcome of an Alberta Health Services (AHS) initiative to reduce the number of service providers in the province. ParaMed's Alberta operations generated revenue of $7.5 million and Adjusted EBITDA of $1.3 million for the year ended December 31, 2012. For 2013, these operations contributed revenue of $4.2 million and Adjusted EBITDA of $0.4 million. In addition, a pre-tax charge of $0.2 million was recognized this year as part of the "loss from asset impairment, disposals and other items" in connection with the discontinuation of the Alberta home health care operations.

In Ontario, ParaMed's ability to grow its government business has been impeded since 2004 when the government froze the competitive bidding process for all operators in the province. In October 2012, the Ministry of Health and Long-Term Care (MOHLTC) implemented a new model for home health care in Ontario that does not involve a bidding process. Instead, the new service delivery model will place greater emphasis on quality of care and value than past arrangements, with service providers' performance evaluated based on these elements. Performance against an established set of indicators will guide decisions during future contract discussions. We expect that our superior quality service delivery will ensure both retention and growth of current volumes under the MOHLTC's plan to grow community based care. For further details, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada – Ontario Home Health Care Legislation and Funding".

Revenue from provincial programs represented approximately 98% of ECI's home health care revenue in 2013 (2012 – 97%). Despite discontinuing operations in Alberta last quarter, ParaMed's average daily home health care hours of service increased by 2.3% this quarter to 13,638 from 13,336 in the 2012 fourth quarter, and increased by 2.8% from 13,268 in the 2013 third quarter. For 2013, ParaMed provided 4,911,000 hours of home health care service (13,456 hours per day) compared to 4,796,000 hours of home health care service, or 13,103 hours per day, provided in 2012. In Ontario, ParaMed increased its daily hours of service provided this quarter by 8.1% to 13,637 over 12,616 provided in the 2012 fourth quarter, and by 4.5% over 13,047 provided in the 2013 third quarter. For 2013, ParaMed provided 4,772,000 hours of home health care service in Ontario, 13,074 hours per day, representing an increase of 5.2% over 12,423 hours per day in 2012.

IMPACT OF U.S. DOLLAR AND FOREIGN CURRENCY TRANSLATION

Impact on Financial Statements

The majority of our operations are conducted in the United States, which accounted for 62.8% of consolidated revenue from continuing operations in 2013 (2012 – 64.2%). As a result, changes in the exchange rates used to translate the results of the U.S. operations to Canadian dollars can affect the comparison of the consolidated results.

The following table illustrates the positive/(negative) effect of changes in the average exchange rates used in translating the U.S. results for the 2013 fourth quarter and for 2013.

	Q4		Year	
Exchange Rate Impact on Periods	**2013**	2012	**2013**	2012
Average U.S./Canadian dollar exchange rate	**1.0489**	0.9916	**1.0299**	0.9996
Continuing Operations *(millions of dollars)*				
Revenue	**17.7**		**37.4**	
Adjusted EBITDA	**1.0**		**2.5**	
Net earnings	**(0.5)**		**(0.5)**	
AFFO	**0.4**		**1.0**	
Same-facility Operations *(millions of dollars)*				
Revenue	**16.7**		**35.1**	
Adjusted EBITDA	**0.8**		**2.1**	

The following table illustrates the contribution from our U.S. operations to selected line items of our financial results and the impact of a one-cent change in the Canadian dollar against the U.S. dollar on those line items, for each of 2013 and 2012.

	Results		Impact of One-Cent Change in Exchange Rate(1)	
U.S. Operations	**2013**	2012	**2013**	2012
(millions of dollars)	***US$***	*US$*	**C$**	C$
Revenue	***1,234.6***	*1,309.0*	**12.3**	13.1
Adjusted EBITDA	***81.4***	*111.1*	**0.8**	1.1
AFFO	***32.8***	*51.4*	**0.3**	0.5

(1) A weaker Canadian dollar against the U.S. dollar has a positive effect on reported results; while a stronger Canadian dollar has a negative effect on reported results.

Impact of Foreign Currency Forward Contract Strategy on Distributions

We have a foreign currency hedging strategy whereby we monitor and consider entering into foreign currency forward contracts (FCFCs) in order to reduce the risks associated with changes in the U.S. dollar and the impact such changes could have on our Canadian dollar cash available for distribution. The Company has not had any FCFCs in place since June 2011. Management continues to monitor the U.S. to Canadian dollar exchange rate and to consider future FCFCs to the extent that they may be beneficial to the Company.

DIVIDEND POLICY

The declaration and payment of dividends by Extendicare is at the discretion of the Board as to the amount and timing of dividends to be declared and paid, after consideration of a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of Extendicare, debt covenants and obligations, and any other factors deemed relevant by the Board. If the Board determines that it would be in Extendicare's best interests, it may reduce, for any period, the amount and frequency of dividends to be distributed to holders of Common Shares.

As previously announced on April 29, 2013, the Board elected to reduce Extendicare's monthly dividend to $0.04 per share from $0.07 per share, commencing with the May 2013 dividend.

Dividends declared in 2013 totalled $52.0 million, or $0.60 per share, representing approximately 73% of total AFFO of $71.1 million, or $0.820 per basic share. For the year ended 2012, distributions declared totalled $71.5 million, or $0.84 per share, representing approximately 85% of total AFFO of $84.6 million.

Taxability of Dividends

Any distributions made by Extendicare Inc. on its Common Shares will be taxed as dividends. Any such dividends that are designated by Extendicare as "eligible dividends" for Canadian federal income tax purposes will qualify for the enhanced dividend tax credit. However, there may be limitations on the ability of Extendicare to designate all or any portion of any dividends as "eligible dividends" and, accordingly, no assurance can be given as to the extent to which any dividends will be designated as "eligible dividends".

For U.S. tax purposes, any distributions made by Extendicare Inc. on its Common Shares to U.S. residents who meet the statutory holding period requirements for their shares, will be treated as a qualified dividend to the extent such distribution is paid from current or accumulated earnings and profits as determined under U.S. federal income tax principles. It is anticipated that Extendicare will calculate its current earnings and profits to determine the portion of its distributions that may be treated as qualified dividends and communicate this information to U.S. shareholders by January 31st following each calendar year end. Extendicare is not required by law to calculate its accumulated earnings and profits under U.S. federal income tax principles and it has not and will not calculate accumulated earnings and profits. Accordingly, any distributions in excess of current earnings and profits are required to be treated as non-qualified dividends.

ADJUSTED FUNDS FROM OPERATIONS

The following table provides a reconciliation of our Adjusted EBITDA to Funds from Operations (FFO) and AFFO on a quarterly and annual basis for each of 2013 and 2012.(1)

(millions of dollars unless otherwise noted)	Q1 2013	Q1 2012	Q2 2013	Q2 2012	Q3 2013	Q3 2012	Q4 2013	Q4 2012	Year 2013	Year 2012
Adjusted EBITDA	**39.1**	49.4	**41.5**	43.6	**43.0**	37.3	**32.1**	52.9	**155.7**	183.2
Depreciation for FFEC	**(5.6)**	(5.8)	**(5.5)**	(6.3)	**(5.5)**	(5.7)	**(5.4)**	(5.8)	**(22.0)**	(23.6)
Accretion costs	**(0.8)**	(0.5)	**(0.8)**	(0.6)	**(1.0)**	(0.5)	**(0.8)**	(0.7)	**(3.4)**	(2.3)
Interest, net	**(14.5)**	(16.2)	**(14.5)**	(14.8)	**(15.2)**	(15.4)	**(14.6)**	(15.3)	**(58.8)**	(61.7)
	18.2	26.9	**20.7**	21.9	**21.3**	15.7	**11.3**	31.1	**71.5**	95.6
Current income tax expense (recovery)(2)	**3.4**	2.9	**0.9**	3.0	**3.7**	3.5	**(3.3)**	(2.4)	**4.7**	7.0
FFO(4)	**14.8**	24.0	**19.8**	18.9	**17.6**	12.2	**14.6**	33.5	**66.8**	88.6
Amortization of financing costs and accretion costs	**1.8**	1.4	**1.7**	0.9	**1.9**	1.3	**1.7**	1.7	**7.1**	5.3
Principal portion of government capital funding payments	**0.7**	0.7	**0.9**	0.7	**0.9**	0.7	**0.9**	0.7	**3.4**	2.8
Additional facility maintenance capital expenditures(3)	**0.9**	1.0	**(0.3)**	(1.0)	**–**	(3.0)	**(6.8)**	(9.1)	**(6.2)**	(12.1)
AFFO(4) (5)	**18.2**	27.1	**22.1**	19.5	**20.4**	11.2	**10.4**	26.8	**71.1**	84.6
Per Basic Share *($)*										
FFO	**0.172**	0.285	**0.228**	0.222	**0.203**	0.143	**0.167**	0.393	**0.770**	1.043
AFFO	**0.211**	0.322	**0.255**	0.230	**0.235**	0.130	**0.119**	0.312	**0.820**	0.994
Per Diluted Share *($)*										
FFO	**0.172**	0.267	**0.219**	0.214	**0.197**	0.145	**0.168**	0.362	**0.756**	0.988
AFFO	**0.203**	0.298	**0.240**	0.221	**0.217**	0.134	**0.124**	0.292	**0.784**	0.945
Distributions *($)*										
Declared *(thousands)*	**18,122**	17,729	**13,004**	17,825	**10,435**	17,922	**10,462**	18,021	**52,023**	71,497
Declared per share	**0.210**	0.210	**0.150**	0.210	**0.120**	0.210	**0.120**	0.210	**0.600**	0.840
Weighted Average Number of Shares *(thousands)*										
Basic	**86,221**	84,347	**86,658**	84,805	**86,922**	85,260	**87,140**	85,736	**86,738**	85,039
Diluted	**103,192**	98,358	**103,628**	98,618	**103,892**	99,604	**104,109**	105,254	**103,708**	100,420

(1) "Adjusted EBITDA", "FFO", and "AFFO" are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS. Refer to the discussion of non-GAAP measures.
(2) Excludes current tax with respect to fair value adjustments, and gains or losses on foreign exchange, financial instruments, asset impairment, disposals and other items that are excluded from the computation of AFFO.
(3) Represents total facility maintenance capital expenditures less depreciation for furniture, fixtures, equipment and computers, or FFEC, already deducted in determining FFO.
(4) In 2012, we reported discontinued operations related to the gain on sale of our U.S. group purchasing organization in January 2012. This gain on sale was excluded in determining FFO or AFFO. Consequently, there was no amount to report as discontinued operations.
(5) A reconciliation of AFFO to cash flow from operating activities is provided under the heading "Liquidity and Capital Resources".

The following provides the segmented AFFO for our U.S. and Canadian operations.

	Q1		Q2		Q3		Q4		Year	
Segmented AFFO *(millions of dollars)*	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
U.S. operations *(US$)*	**9.8**	19.5	**11.6**	10.2	**8.7**	0.9	**2.7**	20.8	**32.8**	51.4
U.S. operations *(C$)*	**9.9**	19.5	**11.9**	10.4	**9.0**	0.8	**3.0**	20.7	**33.8**	51.4
Canadian operations	**8.3**	7.6	**10.2**	9.1	**11.4**	10.4	**7.4**	6.1	**37.3**	33.2
AFFO	**18.2**	27.1	**22.1**	19.5	**20.4**	11.2	**10.4**	26.8	**71.1**	84.6

AFFO Review

2013 FOURTH QUARTER

AFFO was $10.4 million ($0.119 per basic share) in the 2013 fourth quarter compared to $26.8 million ($0.312 per basic share) in the 2012 fourth quarter, representing a decrease of $16.8 million, excluding a $0.4 million positive effect of a weaker Canadian dollar. This decline was primarily due to a decrease in Adjusted EBITDA of $21.8 million, partially offset by the timing of facility maintenance capital expenditures, which were lower by $3.0 million, reduced net interest costs and lower current income taxes. Net interest costs were lower by $0.9 million as a result of our debt refinancing. Current income taxes for the 2013 fourth quarter were recovery of $3.3 million compared to a recovery of $2.4 million in the 2012 fourth quarter. The 2013 and 2012 fourth quarters were favourably impacted by book-to-file tax adjustments of approximately $3.6 million and $4.0 million, respectively, primarily related to our U.S. operations. Excluding these book-to-file adjustments, current income taxes represented 2.3% and 5.2% of pre-tax funds from operations (FFO), respectively. A discussion of Adjusted EBITDA by segmented division can be found under the heading "Summary of Quarterly Results – 2013 Fourth Quarter Financial Review".

2013 YEAR

AFFO was $71.1 million ($0.820 per basic share) in 2013, compared to $84.6 million ($0.994 per basic share) in 2012, representing a decrease of $14.5 million, excluding a $1.0 million positive effect of a weaker Canadian dollar. This decline was primarily due to a $30.0 million decrease in Adjusted EBITDA, partially offset by the timing of facility maintenance capital expenditures, which were lower by $8.1 million, lower interest costs of $4.5 million due to our debt refinancing, and lower current income taxes. Current income taxes were $4.7 million in 2013 compared to $7.0 million in 2012, representing 6.6% and 7.3% of pre-tax FFO, respectively. Both years were favourably impacted by book-to-file tax adjustments of approximately $4.0 million in 2013 and $5.2 million in 2012. In addition, the 2012 first quarter results included a non-taxable premium refund of $3.5 million. Excluding these items, current income taxes represented 12.3% of pre-tax FFO in 2013 compared to 10.8% in 2012. A discussion of Adjusted EBITDA by segmented division can be found under the heading "2013 Financial Review".

The effective tax rates on our FFO can be impacted by: adjustments to our estimates of annual deferred timing differences, particularly when dealing with cash-based tax items versus accounting accruals; changes in the proportion of earnings between taxable and non-taxable entities; book-to-file adjustments for prior year filings; and the ability to utilize loss carryforwards. The restructuring of our Canadian legal entities, along with the elimination of the income trust structure under the 2012 Conversion, enhanced our ability to utilize available non-capital loss carryforwards, which reduced our Canadian current income taxes in the last half of 2012 and during 2013. Our Canadian non-capital loss carryforwards were substantially utilized by the end of 2013. As a result, we anticipate that our annual effective tax rate on FFO will increase in 2014 to between 23% and 26%.

Facility maintenance capital expenditures were $12.2 million in the 2013 fourth quarter, compared to $14.9 million in the 2012 fourth quarter and $5.5 million in the 2013 third quarter, representing 2.4%, 3.0% and 1.1% of revenue, respectively. Facility maintenance capital expenditures totalled $28.2 million in 2013 compared to $35.7 million in 2012, representing 1.4% and 1.8% of revenue, respectively. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend between 1.5% and 2.0% of revenue annually, which is consistent with our objective to maintain and upgrade our centers. In 2014, we are expecting to spend in the range of $38 million to $43 million in facility maintenance capital expenditures and $15 million to $20 million in growth capital expenditures.

SUMMARY OF QUARTERLY RESULTS

The following is a summary of selected consolidated financial information derived from unaudited interim condensed consolidated financial statements for each of the eight most recently completed quarters.

	Q1		Q2		Q3		Q4	
(thousands of dollars unless otherwise noted)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Revenue	**497,957**	517,188	**498,521**	524,686	**508,613**	498,505	**519,374**	497,034
Adjusted EBITDA[(1)]	**39,143**	49,373	**41,455**	43,637	**42,992**	37,305	**32,153**	52,938
Adjusted EBITDA margin	***7.9%***	*9.5%*	***8.3%***	*8.3%*	***8.5%***	*7.5%*	***6.2%***	*10.7%*
Earnings (loss) from continuing operations before separately reported gains/losses, net of taxes[(1)]	**2,762**	9,912	**4,549**	6,384	**4,916**	(3,264)	**(1,893)**	16,500
Average U.S./Canadian dollar exchange rate[(2)]	**1.0083**	1.0011	**1.0234**	1.0103	**1.0385**	0.9956	**1.0489**	0.9916

(1) Refer to discussion of non-GAAP measures, and the reconciliation of these line items to GAAP measures in the table that follows.

(2) These are the actual Bank of Canada average rates of exchange for the period. The year-to-date revenue and expenses of our foreign operations are translated at the average year-to-date rates of exchange, and the results of the quarters are calculated by deducting the previously reported year-to-date results from the current year-to-date results. In addition, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at rates of exchange in effect at the time of the transactions. Therefore, the effective exchange rates calculated from the translated amounts reported above, may differ from the actual average rates of exchange indicated for the period.

The following provides a reconciliation of the line items: (i) "net earnings (loss)" to "earnings (loss) from continuing operations before separately reported gains/losses, net of taxes"; and (ii) "earnings (loss) before income taxes" to "Adjusted EBITDA" for each of the eight most recently completed quarters.

	Q1		Q2		Q3		Q4	
(thousands of dollars)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Net earnings (loss)	**3,846**	49,006	**5,101**	3,675	**4,103**	(4,651)	**(7,798)**	14,626
Add (Deduct)[(1)]**:**								
Fair value adjustment on convertible debentures	**(1,610)**	(4,987)	**(1,044)**	(120)	**(342)**	(2,029)	**(103)**	2,313
Loss on foreign exchange and financial instruments	**518**	–	**–**	1,103	**–**	–	**1**	–
Loss (gain) from asset impairment, disposals and other items	**8**	423	**492**	1,726	**1,155**	3,847	**6,007**	(367)
Discontinued operations	**–**	(34,530)	**–**	–	**–**	(431)	**–**	(72)
Earnings (loss) from continuing operations before separately reported gains/losses, net of taxes	**2,762**	9,912	**4,549**	6,384	**4,916**	(3,264)	**(1,893)**	16,500
Earnings (loss) before income taxes	**5,843**	17,717	**7,060**	4,979	**7,169**	(491)	**(11,477)**	15,990
Add (Deduct):								
Depreciation and amortization	**19,046**	19,355	**19,404**	19,455	**19,530**	19,005	**19,949**	18,990
Net finance costs	**14,243**	11,661	**14,274**	16,393	**15,715**	13,944	**15,346**	18,325
Loss (gain) from asset impairment, disposals and other items	**11**	640	**717**	2,810	**578**	4,847	**8,335**	(367)
Adjusted EBITDA	**39,143**	49,373	**41,455**	43,637	**42,992**	37,305	**32,153**	52,938

(1) The separately reported items being added to or deducted from net earnings (loss) are net of income taxes.

The following provides the quarterly segmented Adjusted EBITDA for our U.S. and Canadian operations.

	Q1		Q2		Q3		Q4	
Segmented Adjusted EBITDA *(thousands of dollars)*	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
U.S. operations *(US$)*	**23,506**	33,721	**23,255**	26,239	**22,688**	17,191	**11,904**	33,923
U.S. operations *(C$)*	**23,701**	33,758	**23,804**	26,544	**23,576**	17,028	**12,704**	33,700
Canadian operations	**15,442**	15,615	**17,651**	17,093	**19,416**	20,277	**19,449**	19,238
Adjusted EBITDA	**39,143**	49,373	**41,455**	43,637	**42,992**	37,305	**32,153**	52,938

There are a number of factors affecting the trend of our quarterly results. For seasonal trends, while year-over-year quarterly comparisons will generally remain appropriate, sequential quarters can vary materially. We already report as separate line items "fair value adjustments", "distributions on Exchangeable LP Units", "loss (gain) on foreign exchange and financial instruments" and "loss (gain) from asset impairment, disposals and other items", which are transitional in nature and would otherwise distort historical trends. With respect to our core operations, the significant factors that impact the results from period to period are as follows:

- Medicare and Managed Care admissions are usually the highest in the first and second quarters; begin to decline during the latter portion of the second quarter; and are generally at their lowest in the summer months when there tends to be fewer elective surgeries performed;
- Medicaid rate changes, including adjustments for CMI and provider taxes, occur with each state's fiscal year, which is July 1st for the majority of the major states in which EHSI operates, and October 1st for Michigan;
- Medicare rate changes generally occur October 1st (federal fiscal year), and typically include a market basket inflationary increase;
- Ontario long-term care providers generally receive annual acuity-based flow-through funding adjustments effective April 1st and accommodation funding increases July 1st, and Alberta long-term care providers generally receive annual inflationary rate increases and acuity-based funding adjustments on April 1st;
- independent actuarial reviews are conducted three times a year, in the second and third quarters and at year end, which may lead to a strengthening, or conversely, a release of the reserves for self-insured liabilities;
- utility costs are generally at their highest in the first quarter and their lowest in the third quarter, with variances between the two of as much as $3.0 million; and
- foreign currency exchange rate fluctuations between the U.S. and Canadian dollars and impact on translation of our U.S. operations from U.S. dollars to Canadian dollars.

Further details on the above can be found under the sections "Overview – Significant 2013 Events and Developments", "Key Performance Indicators", "Impact of U.S. Dollar and Foreign Currency Translation", "Other Significant Developments" and "Update of Regulatory and Reimbursement Changes Affecting Revenue".

2013 Fourth Quarter Financial Review

CONSOLIDATED CONTINUING OPERATIONS

	Q4		Change	
(millions of dollars unless otherwise noted)	**2013**	2012	$	%
Revenue	**519.3**	497.0	22.3	*4.5%*
Operating expenses	**468.8**	426.9	41.9	*9.8%*
Administrative costs	**15.5**	14.5	1.0	*6.9%*
Lease costs	**2.9**	2.7	0.2	*7.4%*
Adjusted EBITDA	**32.1**	52.9	(20.8)	*(39.3)%*
Adjusted EBITDA as a % of revenue	***6.2%***	*10.7%*		
Average U.S./Canadian dollar exchange rate	**1.0489**	0.9916		

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 1.0489 for the 2013 fourth quarter and 0.9916 for the 2012 fourth quarter. However, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at the rates of exchange in effect at the time of the transactions.

Highlights *(variances exclude effect of foreign exchange)*

- Revenue of $519.3 million in the 2013 fourth quarter, included a $6.7 million increase in same-facility operations over the 2012 fourth quarter.
- Average daily Medicare Part A rate decreased by 0.3% this quarter over the 2012 fourth quarter, and the Managed Care rate increased by 1.3%.
- Adjusted EBITDA of $32.1 million in the 2013 fourth quarter declined by $21.8 million over the 2012 fourth quarter.
- Adjusted EBITDA included an increase in the provision for self-insured liabilities of $14.3 million over Q4 2012.
- Adjusted EBITDA margin of 6.2% in the 2013 fourth quarter declined from 10.7% in the 2012 fourth quarter.

Consolidated revenue from continuing operations increased by $22.3 million to $519.3 million in the 2013 fourth quarter from $497.0 million in the 2012 fourth quarter. Non same-facility operations contributed $28.4 million to revenue this quarter and $29.5 million in the 2012 fourth quarter, for a net decline between quarters of $1.1 million. Refer to the glossary under the heading "Key Performance Indicators" for a description of what has been included in non same-facility operations. Excluding a $16.7 million positive effect of a weaker Canadian dollar, revenue from same-facility operations increased by $6.7 million, due to an improvement from our Canadian operations, partially offset by lower revenue from our U.S. operations. Details by segmented operations are discussed below.

Consolidated Adjusted EBITDA from continuing operations declined by $20.8 million to $32.1 million this quarter from $52.9 million in the 2012 fourth quarter, representing 6.2% and 10.7% of revenue, respectively. Non same-facility operations generated Adjusted EBITDA of $3.7 million this quarter and $3.6 million in the 2012 fourth quarter, for a net improvement of $0.1 million between periods. Excluding a $0.8 million positive effect of a weaker Canadian dollar, same-facility Adjusted EBITDA decreased by $21.7 million. The U.S. operations contributed $22.2 million, or US$22.2 million, to this decline, which included a US$14.3 million increase in the provision for self-insured liabilities, a US$4.8 million increase in labour costs primarily due to a change in vacation policy that favourably impacted the 2012 fourth quarter, and a US$3.0 million decrease in prior period revenue settlement adjustments, partially offset by a refund of prior period charges of US$2.0 million recorded in the 2013 fourth quarter. Adjusted EBITDA from same-facility Canadian operations improved by $0.5 million this quarter. Details by segmented operations are discussed below.

Consolidated labour-related costs represented 71.9% of operating and administrative costs in the 2013 fourth quarter compared to 74.3% in the 2012 fourth quarter, and as a percentage of revenue, were 67.1% and 66.0%, respectively. The decline as a percentage of operating and administrative costs this quarter was primarily due to the increase in the provision for self-insured liabilities.

U.S. CONTINUING OPERATIONS

	Q4 2013		Q4 2012		Change	
(millions of dollars unless otherwise noted)	**US$**	**C$**	US$	C$	US$	%
Revenue	**307.2**	***322.3***	313.6	*310.8*	(6.4)	*(2.0)%*
Operating expenses	**284.2**	***298.0***	268.0	*265.5*	16.2	*6.0%*
Administrative costs	**9.3**	***9.8***	10.1	*10.1*	(0.8)	*(7.9)%*
Lease costs	**1.7**	***1.8***	1.6	*1.5*	0.1	*6.3%*
Adjusted EBITDA	**12.0**	***12.7***	33.9	*33.7*	(21.9)	*(64.6)%*
Adjusted EBITDA margin	***3.9%***		*10.8%*			

Revenue from U.S. operations in its functional currency declined by US$6.4 million to US$307.2 million in the 2013 fourth quarter compared to US$313.6 million in the 2012 fourth quarter. Non same-facility operations generated revenue of US$18.1 million this quarter compared to US$19.8 million in the 2012 fourth quarter, for a net decline of US$1.7 million. Refer to the glossary under the heading "Key Performance Indicators" for a description of what has been included in non same-facility operations. Revenue from same-facility operations declined by US$4.7 million between periods, primarily due to lower census levels and a decline in prior period revenue settlements, partially offset by a net increase in average rates. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

Same-facility Revenue: 2013 Fourth Quarter Compared to 2012 Fourth Quarter *(US$ millions)*

(7.4)	– decrease in skilled nursing center resident census (decrease in Medicare $3.6 million, Medicaid $4.6 million, and private/other $0.3 million, partially offset by an increase in Managed Care $1.1 million)
5.6	– increase in average skilled nursing center rates (Medicaid $5.0 million and private/other $1.2 million, partially offset by a decrease in Managed Care $0.6 million)
(3.0)	– decrease in prior period revenue settlement adjustments (charge of $0.7 million in 2013 versus a receipt of $2.3 million in 2012)
0.1	– increase in other revenue
(4.7)	

Operating, administrative and lease costs increased by US$15.5 million to US$295.2 million this quarter compared to US$279.7 million in the 2012 fourth quarter, and were impacted by a reduction in costs from non same-facility operations of US$1.9 million. Costs associated with same-facility operations increased by US$17.4 million, primarily due to a US$14.3 million increase in the provision for self-insured liabilities, a US$4.8 million increase in labour costs primarily due to a change in vacation policy that favourably impacted the 2012 fourth quarter, and other cost increases of US$0.3 million, partially offset by a refund of prior period charges of US$2.0 million recorded in the 2013 fourth quarter. For more information on the provision for self-insured liabilities, refer to the discussion under the heading "Accrual for Self-insured Liabilities" found within the "Liquidity and Capital Resources" section of this MD&A. Labour-related costs from total operations represented 66.1% of operating and administrative costs this quarter, compared to 68.2% in the 2012 fourth quarter, and as a percentage of revenue were 63.1% and 60.5%, respectively.

Adjusted EBITDA from U.S. operations declined by US$21.9 million to US$12.0 million in the 2013 fourth quarter from US$33.9 million in the 2012 fourth quarter, representing 3.9% and 10.8% of revenue, respectively. Adjusted EBITDA from non same-facility operations increased by US$0.2 million (US$2.7 million contribution this quarter compared to US$2.5 million in the same 2012 period). Adjusted EBITDA from same-facility operations decreased by US$22.1 million as a result of higher costs of US$17.4 million and lower revenue of US$4.7 million, as previously discussed.

CANADIAN CONTINUING OPERATIONS

	Q4		Change	
(millions of dollars unless otherwise noted)	**2013**	2012	$	%
Revenue	**197.0**	186.2	10.8	*5.8%*
Operating expenses	**170.8**	161.4	9.4	*5.8%*
Administrative costs	**5.7**	4.4	1.3	*29.5%*
Lease costs	**1.1**	1.2	(0.1)	*(8.3)%*
Adjusted EBITDA	**19.4**	19.2	0.2	*1.0%*
Adjusted EBITDA margin	***9.9%***	*10.3%*		

Revenue from Canadian operations grew by $10.8 million to $197.0 million in the 2013 fourth quarter from $186.2 million in the 2012 fourth quarter. Non same-facility operations generated revenue of $9.4 million this quarter compared to $10.1 million in the 2012 fourth quarter, for a net decrease of $0.7 million, which resulted from the discontinuation of the Alberta home health care business, partially offset by the opening of the two new replacement nursing centers in Ontario. Refer to the glossary under the heading "Key Performance Indicators" for a description of what has been included in non same-facility operations. Revenue from same-facility operations improved by $11.5 million between periods due to: growth from nursing and assisted living center operations of $7.8 million, primarily due to funding enhancements, the timing of recognition of revenue under the Ontario envelope system, and a favourable prior period revenue settlement adjustment of $1.2 million recorded in the 2013 fourth quarter; growth from the Ontario home health care operations of $3.0 million, primarily due to an 8.1% increase in daily volumes; and an increase in other revenue of $0.7 million, primarily due to additional centers under management.

Operating, administrative and lease costs increased by $10.6 million to $177.6 million this quarter from $167.0 million in the 2012 fourth quarter. Costs from non same-facility operations were $8.6 million this quarter compared to $9.0 million in the same 2012 period, for a net decrease of $0.4 million. Costs from same-facility operations increased by $11.0 million and included an increase in labour-related costs of $5.9 million, and higher non-wage costs of care, primarily due to the timing of spending under the Ontario nursing center envelope system. Labour-related costs from total operations represented 82.1% of operating and administrative costs this quarter, compared to 84.3% in the 2012 fourth quarter, and as a percentage of revenue were 73.5% and 75.1%, respectively.

Adjusted EBITDA from Canadian operations improved $0.2 million to $19.4 million in the 2013 fourth quarter from $19.2 million in the 2012 fourth quarter, representing 9.9% and 10.3% of revenue, respectively. Adjusted EBITDA from non same-facility operations declined by $0.3 million ($0.8 million contribution this quarter compared to $1.1 million in the same 2012 period). Adjusted EBITDA from same-facility operations improved by $0.5 million, due to higher revenue of $11.5 million, partially offset by increased costs of $11.0 million, as discussed above.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization costs increased by $0.9 million to $19.9 million in the 2013 fourth quarter from $19.0 million in the 2012 fourth quarter, primarily due to a $0.8 million negative effect of a weaker Canadian dollar.

LOSS (GAIN) FROM ASSET IMPAIRMENT, DISPOSALS AND OTHER ITEMS

Extendicare recorded a pre-tax loss of $8.3 million in the 2013 fourth quarter related to: an $8.1 million charge for asset impairment, $7.3 million of which related to the 11 U.S. nursing centers held for sale, and $0.8 million related to the downsizing of one of our nursing centers in Canada upon opening of a new center; and $1.3 million in advisor fees in connection with the Board's strategic review; partially offset by a $1.0 million gain on sale of two closed nursing centers in Canada; and a favourable $0.1 million adjustment to the ParaMed Alberta closing costs. In comparison, we recorded a pre-tax gain of $0.4 million in the 2012 fourth quarter related to the redemption of our 2013 Convertible Debentures. For further information, refer to *note 20* of the 2013 consolidated financial statements.

NET FINANCE COSTS

Net finance costs of $15.3 million in the 2013 fourth quarter were $3.0 million lower than the 2012 fourth quarter level of $18.3 million. This was largely due to a favourable change of $2.4 million with respect to the fair value adjustments on convertible debentures and lower net interest costs of $0.7 million, partially offset by an increase in accretion costs of $0.1 million.

The following table summarizes the components of net finance costs.

	Q4		Change	
(millions of dollars unless otherwise noted)	**2013**	2012	$	%
Interest, Net				
Interest expense	**16.0**	16.6	(0.6)	*(3.6)%*
Interest revenue	**(1.4)**	(1.3)	(0.1)	*7.7%*
	14.6	15.3	(0.7)	*(4.6)%*
Accretion				
Accretion of decommissioning provisions	**0.4**	0.4	–	–
Other accretion	**0.4**	0.3	0.1	*33.3%*
	0.8	0.7	0.1	*14.3%*
Fair value adjustment on convertible debentures	**(0.1)**	2.3	(2.4)	*(104.3)%*
Net finance costs	**15.3**	18.3	(3.0)	*(16.4)%*

INCOME TAXES

The tax provision from continuing operations was a recovery of $3.6 million on a pre-tax loss of $11.4 million in the 2013 fourth quarter compared to a tax provision of $1.5 million on pre-tax earnings of $16.0 million in the 2012 fourth quarter. The effective tax rates for each period were distorted by, among other things, the fair value adjustments, gains and losses from financial instruments, foreign exchange, asset impairment, disposals, and other items. The effective tax rate on earnings from continuing operations before separately reported items was 41.6% this quarter compared to 8.0% in the 2012 fourth quarter. As well, both quarters were impacted by favourable book-to-file adjustments of $2.7 million in the 2013 fourth quarter and $3.3 million in the 2012 fourth quarter. After excluding these items, the 2013 fourth quarter reflected a tax provision of $1.4 million on a pre-tax loss of $3.2 million, because of the non-taxable provision for self-insured liabilities. In comparison, after excluding the above items, the tax provision for the 2012 fourth quarter was $4.8 million on pre-tax earnings of $17.9 million, representing an effective tax rate of 26.6%.

2013 SELECTED ANNUAL INFORMATION

The following is a summary of selected annual financial information.

(thousands of dollars unless otherwise noted) Years ended December 31	**2013**	2012	2011
Revenue	**2,024,465**	2,037,413	2,094,082
Operating expenses	**1,793,368**	1,780,019	1,813,792
Administrative costs	**64,258**	63,155	69,155
Lease costs	**11,096**	10,986	10,999
Total expenses	**1,868,722**	1,854,160	1,893,946
EBITDA	**155,743**	183,253	200,136
Depreciation and amortization	**77,929**	76,805	76,577
Loss from asset impairment, disposals, financing and other items	**9,641**	7,930	62,496
Results from operating activities	**68,173**	98,518	61,063
Interest, net	**58,778**	61,741	85,312
Accretion	**3,380**	2,302	2,029
Distributions on Exchangeable LP Units	**–**	–	2,179
Fair value adjustments	**(3,099)**	(4,823)	(6,023)
Loss (gain) on foreign exchange and financial instruments	**519**	1,103	(553)
Net finance costs	**59,578**	60,323	82,944
Earnings (loss) from continuing operations before income taxes	**8,595**	38,195	(21,881)
Income tax expense	**3,343**	10,572	13,442
Earnings (loss) from continuing operations	**5,252**	27,623	(35,323)
Discontinued operations	**–**	35,033	4,927
Net earnings (loss)	**5,252**	62,656	(30,396)
Add (Deduct):			
Fair value adjustment on convertible debentures, net of taxes	**(3,099)**	(4,823)	577
Fair value adjustment on Exchangeable LP Units, net of taxes	**–**	–	(6,600)
Loss (gain) on foreign exchange and financial instruments, net of taxes	**519**	1,103	(655)
Loss from asset impairment, disposals and other items, net of taxes	**7,662**	5,629	46,808
Distributions on Exchangeable LP Units, net of taxes	**–**	–	2,179
Discontinued operations, net of taxes	**–**	(35,033)	(4,927)
Earnings from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	**10,334**	29,532	6,986
Cash distributions per share/unit ($)	**0.60**	0.84	0.84
Total assets *(at year end)*	**1,849,088**	1,807,916	1,830,704
Long-term debt *(at year end)*	**1,016,785**	1,038,787	941,742
Long-term debt including current portion *(at year end)*	**1,164,836**	1,132,235	1,134,440
U.S./Canadian dollar exchange rate			
Average rate for the year	**1.0299**	0.9996	0.9891
Closing rate at year end	**1.0636**	0.9949	1.0170

The closing rates used to translate the assets and liabilities of our U.S. operations were 1.0636 at December 31, 2013, 0.9949 at December 31, 2012, and 1.0170 at December 31, 2011. Total assets at the end of 2012 of $1,807.9 million declined by $22.8 million from $1,830.7 million at the end of 2011, primarily as a result of the stronger Canadian dollar at the end of 2012, which reduced assets by approximately $30.5 million, and was partially offset by an increase in property and equipment due to the construction of two new nursing centers in Canada. Total assets at the end of 2013 of $1,849.1 million increased by $41.2 million from $1,807.9 million at the end 2012, primarily due to the impact of a weaker Canadian dollar at the end of 2013, which increased the assets of our U.S. operations by $89.1 million, and was partially offset by a decline in the balance of property and equipment as a result of depreciation in excess of capital expenditures.

A comparison between the 2013 and the 2012 results is provided in the following discussion "2013 Financial Review" and under the heading "Liquidity and Capital Resources".

2013 FINANCIAL REVIEW

The following is a summary by reporting segment of "revenue", "Adjusted EBITDA", "net finance costs", "net earnings", and "earnings from continuing operations before separately reported gains/losses".

				2013				2012
(millions of dollars unless otherwise noted)	**U.S.**	**U.S.**	**Canada**	**Total**	U.S.	U.S.	Canada	Total
	(US$)				*(US$)*			
Revenue	***1,234.6***	**1,271.5**	**752.9**	**2,024.4**	*1,309.0*	1,308.5	728.9	2,037.4
Operating expenses	***1,104.6***	**1,137.6**	**655.7**	**1,793.3**	*1,147.5*	1,147.0	633.0	1,780.0
Administrative costs	***42.2***	**43.5**	**20.8**	**64.3**	*43.9*	44.0	19.2	63.2
Lease costs	***6.4***	**6.6**	**4.5**	**11.1**	*6.5*	6.5	4.5	11.0
Total expenses	***1,153.2***	**1,187.7**	**681.0**	**1,868.7**	*1,197.9*	1,197.5	656.7	1,854.2
Adjusted EBITDA	***81.4***	**83.8**	**71.9**	**155.7**	*111.1*	111.0	72.2	183.2
Depreciation and amortization	***57.7***	**59.4**	**18.5**	**77.9**	*58.4*	58.4	18.4	76.8
Loss from asset impairment, disposals and other items	***7.2***	**7.7**	**1.9**	**9.6**	*4.6*	4.7	3.2	7.9
Earnings before net finance costs and income taxes	***16.5***	**16.7**	**51.5**	**68.2**	*48.1*	47.9	50.6	98.5
Interest, net	***27.7***	**28.5**	**30.3**	**58.8**	*32.2*	32.2	29.5	61.7
Accretion	***2.3***	**2.4**	**1.0**	**3.4**	*1.8*	1.7	0.6	2.3
Fair value adjustments	–	–	**(3.1)**	**(3.1)**	–	–	(4.8)	(4.8)
Loss on foreign exchange and financial instruments	–	–	**0.5**	**0.5**	–	–	1.1	1.1
Net finance costs	***30.0***	**30.9**	**28.7**	**59.6**	*34.0*	33.9	26.4	60.3
Earnings (loss) from continuing operations before income taxes	***(13.5)***	**(14.2)**	**22.8**	**8.6**	*14.1*	14.0	24.2	38.2
Income tax expense (recovery)								
Current	***3.2***	**3.3**	**1.3**	**4.6**	*2.9*	2.9	2.3	5.2
Deferred	***(6.0)***	**(6.3)**	**5.1**	**(1.2)**	*3.2*	3.2	2.2	5.4
Total income tax expense	***(2.8)***	**(3.0)**	**6.4**	**3.4**	*6.1*	6.1	4.5	10.6
Earnings (loss) from continuing operations	***(10.7)***	**(11.2)**	**16.4**	**5.2**	*8.0*	7.9	19.7	27.6
Discontinued operations	–	–	–	–	*34.5*	35.0	–	35.0
Net earnings (loss)	***(10.7)***	**(11.2)**	**16.4**	**5.2**	*42.5*	42.9	19.7	62.6
Add (Deduct)[(1)]**:**								
Fair value adjustment on convertible debentures	–	–	**(3.1)**	**(3.1)**	–	–	(4.8)	(4.8)
Loss on foreign exchange and financial instruments	–	–	**0.5**	**0.5**	–	–	1.1	1.1
Loss from asset impairment, disposals and other items	***5.8***	**6.1**	**1.6**	**7.7**	*3.2*	3.3	2.3	5.6
Discontinued operations	–	–	–	–	*(34.5)*	(35.0)	–	(35.0)
Earnings (loss) from continuing operations before separately reported gains/losses, net of taxes	***(4.9)***	**(5.1)**	**15.4**	**10.3**	*11.2*	11.2	18.3	29.5
Average U.S./Canadian dollar exchange rate				**1.0299**				0.9996

(1) The separately reported items being added to or deducted from net earnings are net of income taxes.

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 1.0299 for 2013 and 0.9996 for 2012. However, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at the rates of exchange in effect at the time of the transactions.

Consolidated Continuing Operations

Highlights *(variances exclude effect of foreign exchange)*

- Revenue of $2,024.4 million included a $19.6 million increase in same-facility operations over 2012.
- Average daily revenue rates for Medicare Part A and Managed Care in 2013 increased by 1.9% and 2.5%, respectively, over 2012.
- Adjusted EBITDA of $155.7 million in 2013 declined by $30.0 million, due to an increase in reserves for self-insured liabilities and lower U.S. census levels.
- Adjusted EBITDA margin of 7.7% in 2013 compared to 9.0% in 2012.

Consolidated revenue from continuing operations declined by $13.0 million to $2,024.4 million in 2013 from $2,037.4 million in 2012. Non same-facility operations contributed $116.3 million to revenue this year and $184.0 million in 2012, for a net decline of $67.7 million between years, largely due to the ceasing of operations in the State of Kentucky. Refer to the glossary under the heading "Key Performance Indicators" for a description of what has been included in non same-facility operations. Excluding a $35.1 million positive effect of a weaker Canadian dollar, growth in revenue from same-facility operations was $19.6 million, with an improvement from the Canadian operations of $25.1 million, partially offset by lower revenue from the U.S. operations. Details by segmented operations are discussed below.

Consolidated Adjusted EBITDA from continuing operations declined by $27.5 million to $155.7 million in 2013 from $183.2 million in 2012, representing 7.7% and 9.0% of revenue, respectively. Non same-facility operations generated Adjusted EBITDA of $16.2 million this year and $21.1 million in 2012, for a net decline of $4.9 million. Excluding a $2.1 million positive effect of a weaker Canadian dollar, Adjusted EBITDA from same-facility operations decreased by $24.7 million, as a result of a $26.1 million decline from the U.S. operations, partially offset by a $1.4 million improvement from the Canadian operations. Details by segmented operations are discussed below.

Consolidated labour-related costs in 2013 and 2012 represented 73.4% and 74.0% of operating and administrative costs, respectively, and as a percentage of revenue, were 67.4% and 66.9%, respectively.

U.S. Continuing Operations

Revenue from U.S. operations in its functional currency declined by US$74.4 million to US$1,234.6 million in 2013 compared to US$1,309.0 million in 2012. Non same-facility operations generated revenue of US$76.3 million this period compared to US$145.3 million in 2012, for a net decline of US$69.0 million, of which US$64.0 million was due to the leasing out of our Kentucky operations and the balance related to the 11 skilled nursing centers held for sale and the closure of the rehabilitation hospital. Revenue from same-facility operations declined by US$5.4 million between years primarily due to lower census levels and one less day this year, partially offset by an increase in average revenue rates. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

Same-facility Revenue: 2013 Compared to 2012 *(US$ millions)*

35.9	– increase in average skilled nursing center rates (Medicare $4.0 million, Managed Care $1.1 million, Medicaid $27.6 million and private/other $3.2 million)
(29.5)	– decrease in skilled nursing center resident census (decrease in Medicare $13.9 million, and Medicaid $17.2 million, partially offset by an increase in Managed Care $1.4 million and private/other $0.2 million)
(3.0)	– decrease in nursing ancillary revenue (including declines of $1.3 million for Part B denials in excess of annual limit, and $2.5 million due to change in MPPR percentage effective April 1, 2013)
(3.0)	– decrease in prior period revenue settlement adjustments (charge of $0.4 million in 2013 versus a receipt of $2.6 million in 2012)
(2.8)	– decrease due to one less day this year
(3.0)	– decrease in other revenue
(5.4)	

Operating, administrative and lease costs decreased by US$44.7 million to US$1,153.2 million in 2013 compared to US$1,197.9 million in 2012, and were impacted by a reduction in costs from non same-facility operations of US$65.3 million, of which US$62.1 million was due to the leasing out of our Kentucky operations. Costs associated with same-facility operations increased by US$20.6 million, primarily due to an increase in the provision for self-insured liabilities of US$18.4 million, a premium refund of US$3.5 million received in the 2012 first quarter, and other net cost increases of US$1.8 million, partially offset by a refund of prior period charges of US$2.0 million, and lower labour-related costs of US$1.1 million, which included favourable workers' compensation adjustments of US$2.7 million. For more information on the provision for self-insured liabilities, refer to the discussion under the heading "Accrual for Self-insured Liabilities" found within the "Liquidity and Capital Resources" section of this MD&A. Labour-related costs from total operations in 2013 and 2012 represented 67.5% and 68.5% of operating and administrative costs, respectively, and as a percentage of revenue were 62.7% and 62.3%, respectively.

Adjusted EBITDA from U.S. operations declined by US$29.7 million to US$81.4 million in 2013 from US$111.1 million in 2012, representing 6.6% and 8.5% of revenue, respectively. Adjusted EBITDA from non same-facility operations declined by US$3.7 million between years (US$13.1 million in 2013 compared to US$16.8 million in 2012). Adjusted EBITDA from same-facility operations declined by US$26.0 million as a result of lower revenue of US$5.4 million and higher costs of US$20.6 million, as previously discussed.

Canadian Continuing Operations

Revenue from Canadian operations grew by $24.0 million to $752.9 million in 2013 from $728.9 million in 2012. Non same-facility operations generated revenue of $37.7 million in 2013 compared to $38.8 million in 2012, for a net decrease of $1.1 million, of which $3.3 million was due to the discontinuance of home health care in Alberta, partially offset by the impact of two new centers in northern Ontario. Refer to the glossary under the heading "Key Performance Indicators" for a description of what has been included in non same-facility operations. Revenue from same-facility operations improved by $25.1 million between years due to: growth from nursing and assisted living center operations of $16.4 million, primarily due to funding enhancements; growth from Ontario home health care operations of $7.1 million, primarily due to a 5.2% increase in daily volumes; and other revenue of $1.6 million, primarily due to additional centers under management.

Operating, administrative and lease costs increased by $24.3 million to $681.0 million in 2013 from $656.7 million in 2012. Costs from non same-facility operations were $35.0 million this year compared to $34.4 million in 2012, for a net increase of $0.6 million primarily due to higher costs of approximately $3.0 million related to the start up of two new centers in northern Ontario, partially offset by the discontinuance of home health care in Alberta. Costs from same-facility operations increased by $23.7 million, primarily due to higher labour-related costs of $18.6 million, and higher non-wage costs of $5.1 million, primarily related to enhanced funding for resident care within the Ontario envelope system. Labour-related costs from total operations in 2013 and 2012 represented 83.7% and 84.0% of operating and administrative costs, respectively, and as a percentage of revenue were 75.2% in both years.

Adjusted EBITDA from Canadian operations was $71.9 million in 2013 compared to $72.2 million in 2012, representing 9.6% and 9.9% of revenue, respectively. Non same-facility operations contributed Adjusted EBITDA of $2.7 million this year compared to $4.4 million in 2012, for a net decline of $1.7 million between years, of which $0.9 million was from the discontinuance of home health care in Alberta and the balance related to the new centers in northern Ontario. Improvements from same-facility operations of $1.4 million resulted from higher revenue of $25.1 million, partially offset by higher costs of $23.7 million, as previously discussed.

Depreciation and Amortization

Depreciation and amortization costs of $77.9 million in 2013 were higher by $1.1 million from $76.8 million in 2012, and included a $1.7 million unfavourable impact of a weaker Canadian dollar, partially offset by a reduction of depreciation and amortization of $0.6 million, primarily due to having fully depreciated certain assets.

Loss from Asset Impairment, Disposals and Other Items

Extendicare recorded a pre-tax loss of $9.6 million in 2013 related to: an $8.0 million charge for asset impairment, $7.3 million of which related to the 11 U.S. nursing centers held for sale; $2.1 million in advisor fees in connection with the Board's strategic review; a $0.7 million charge in connection with the early retirement of debt; and a $0.2 million charge in connection with the closing of our Alberta home health care operations; partially offset by a $1.4 million gain on the sale of three closed nursing centers in Canada. In comparison, we recorded a pre-tax loss of $7.9 million in 2012 related to: a non-cash asset impairment charge of $2.8 million; a $3.6 million loss in connection with the Kentucky lease transaction; and a $1.5 million charge in connection with the early retirement of debt and the 2012 Conversion. For further information, refer to *note 20* of the 2013 consolidated financial statements.

Net Finance Costs

Net finance costs of $59.6 million in 2013 were $0.7 million lower than $60.3 million incurred in 2012. This was due to lower net interest costs of $2.9 million resulting from the debt refinancing, partially offset by a net $1.1 million unfavourable change in the fair value adjustments and loss on foreign exchange and financial instruments, and an increase in accretion costs of $1.1 million primarily related to the issuance of convertible debentures in the latter part of 2012.

The following table summarizes the components of net finance costs.

			Change	
(millions of dollars unless otherwise noted)	**2013**	2012	$	%
Interest, Net				
Interest expense	**63.5**	65.3	(1.8)	*(2.8)%*
Interest revenue	**(4.7)**	(3.6)	(1.1)	*30.6%*
	58.8	61.7	(2.9)	*(4.7)%*
Accretion				
Accretion of decommissioning provisions	**1.8**	1.7	0.1	*5.9%*
Other accretion	**1.6**	0.6	1.0	*166.7%*
	3.4	2.3	1.1	*47.8%*
Fair Value Adjustments and Loss on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	**(3.1)**	(4.8)	1.7	*(35.4)%*
Loss on foreign exchange and financial instruments	**0.5**	1.1	(0.6)	*(54.5)%*
	(2.6)	(3.7)	1.1	*(29.7)%*
Net finance costs	**59.6**	60.3	(0.7)	*(1.2)%*

Income Taxes

The tax provision from continuing operations was $3.4 million on pre-tax earnings of $8.6 million in 2013 compared to $10.6 million on pre-tax earnings of $38.2 million in 2012, representing effective tax rates of 38.9% and 27.7%, respectively. The effective tax rates for each period were distorted by, among other things, the fair value adjustments, gains and losses from financial instruments, foreign exchange, asset impairment, disposals, and other items. The effective tax rate on earnings from continuing operations before separately reported items was 34.0% this year compared to 30.4% in 2012. As well, both quarters were impacted by favourable book-to-file adjustments of $3.4 million in 2013 and $4.4 million in 2012. Excluding these items, the effective tax rate was 55.8% this year compared to 40.7% in 2012. This change in rates was primarily due to the change in proportion of income among our taxable and non-taxable entities.

OTHER SIGNIFICANT DEVELOPMENTS

The discussion under the heading "Overview – Significant 2013 Events and Developments", summarizes the following items: the Medicare update; the 2013 U.S. PrivateBank loan refinancing; the 2013/2014 Canadian mortgage refinancings; and legal proceedings and regulatory actions. This section provides a summary of other developments that have impacted the financial results or operations of Extendicare for 2013 in comparison to 2012.

Development Projects

The following table depicts the status of the development projects in Ontario, Canada, with further details provided below.

			New Centers		Owned/Leased Centers Closed	
Development Projects *(as at December 31, 2013)*	Completion Date	Opening Date	No. of Centers	No. of Beds	No. of Centers	No. of Beds
Canada – Owned Long-term Care Centers						
Sault Ste. Marie, Ontario	March/13	April/13	1	256	(2)	(263)
Timmins, Ontario	October/13	October/13	1	180	(1)	(119)
			2	**436**	**(3)**	**(382)**

In 2009, under the first phase of the MOHLTC's redevelopment program for older long-term care centers, ECI received approval to redevelop 382 beds in the cities of Timmins and Sault Ste. Marie and to add an additional 54 long-term care beds to its portfolio. Prior to completion of the new projects, ECI operated three nursing centers with 387 class "C" beds and leased one center with 95 interim beds in Timmins and Sault Ste. Marie. A new 256-bed nursing center in Sault Ste. Marie was completed in March 2013 and opened to residents in April 2013, following which we closed one of our owned centers and the leased center in the community. A new 180-bed nursing center in Timmins was completed and opened to residents in October 2013, following which we closed our existing owned center in the community. With the completion of these projects in Sault Ste. Marie and Timmins, ECI now owns and operates in these communities, 436 beds in two new centers and 100 class "C" beds in an existing center to be considered for redevelopment at a later date. For further information on the MOHLTC redevelopment program, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada – Ontario Redevelopment Program".

The cost of the two Ontario projects was approximately $80 million. Conventional financing for approximately 88% of the total estimated cost for the two projects was secured in 2011. In addition, we are receiving a capital funding subsidy from the MOHLTC of approximately $2.0 million annually over a 25-year period. The combined annual Adjusted EBITDA of the four existing centers (482 beds) was approximately $3.0 million in 2012. It is anticipated that once the new centers are fully operational the incremental Adjusted EBITDA for the three centers (536 beds) will be approximately $1.8 million, excluding the capital funding for the two new centers (436 beds).

Financing Activity

CANADA

Royal Bank of Canada Credit Facility

Extendicare has a demand credit facility with the Royal Bank of Canada (the "RBC Credit Facility") that, as at December 31, 2013, was secured by 13 class "C" nursing centers in Ontario and is guaranteed by certain Canadian subsidiaries of Extendicare. During 2013, the demand working capital line was reduced to $64.0 million from $70.0 million following the completion of two new nursing centers in northern Ontario, which resulted in the transfer of licensed beds from nursing centers that secured the line to conventional financing for the new centers.

As at December 31, 2013, Extendicare had letters of credit totalling $42.3 million issued under the working capital line, of which $42.0 million was issued to secure executive pension obligations, and $0.3 million related to construction projects. The RBC Credit Facility has no financial covenants, but does contain normal and customary terms including the periodic re-appraisal of the centers that could limit the maximum amount available under the working capital line.

2012 Issue of 2019 Convertible Debentures and Redemption of 2013 Convertible Debentures

In 2012, Extendicare issued $126.5 million of aggregate principal amount of 6.00% convertible unsecured debentures due September 30, 2019, convertible at $11.25 per common share (the "2019 Debentures"). The initial offering for $110.0 million of the 2019 Debentures closed on September 25, 2012, and the exercise of the over-allotment option for $16.5 million closed on October 1, 2012.

The net proceeds from the offering were approximately $120.7 million, of which $94.0 million was used by Extendicare to redeem all of Extendicare's outstanding 7.25% convertible unsecured subordinate debentures due June 30, 2013 (the "2013 Debentures") on October 29, 2012. The redemption price of the 2013 Debentures was $94.0 million (principal of $91.8 million with accrued and unpaid interest of $2.2 million).

2011/2012 CMHC Mortgage Refinancing

In December 2011, Extendicare's Canadian operations refinanced $72.4 million of CMHC-insured mortgages secured by 20 centers that were at fixed rates of 9.81%, maturing in March 2013. The new CMHC-insured mortgages consisted of $36.2 million secured by nine centers at a fixed rate of 2.986% maturing in 2022, $22.9 million secured by nine centers at a fixed rate of 2.22% maturing in 2017, and variable-rate bridge loans for $13.3 million secured by two centers. A prepayment penalty of approximately $7.5 million was recognized in the 2011 fourth quarter. The annualized interest savings from this refinancing is estimated to be $5 million. The variable-rate bridge loans of $13.3 million were refinanced during 2012 with fixed-rate CMHC mortgages totalling $19.5 million with a weighted average interest rate of 3.03%, due in 2022.

Mortgage Activity – Development Projects

In January 2012, ECI replaced a construction loan on its new nursing center in Edmonton, Alberta, with a 10-year $17.4 million CMHC-insured mortgage at a fixed rate of 3.81%, with payments amortized over 30 years.

UNITED STATES

2011/2012 Refinancing Plan – HUD Mortgages

During 2012, EHSI completed the refinancing of approximately US$636 million of debt with approximately US$506 million in HUD-insured mortgages and US$130 million of cash on hand. During 2011 and 2012, EHSI closed on 68 HUD loans with a principal balance of US$506.3 million in connection with this refinancing. These new HUD-insured mortgages have a weighted average interest rate of approximately 4.33%, inclusive of MIP, and term to maturity of about 33 years. The annualized interest savings from the refinancing is estimated to be US$20 million.

In July 2010, EHSI received approval as a corporate entity to proceed with HUD applications, subject to an overall limit of US$550.0 million, and in December 2011, received approval to increase the overall limit to US$585.0 million, which expires in September 2014. EHSI already had approximately US$27 million of HUD loans issued prior to refinancing of approximately US$506 million. In April 2013, EHSI refinanced the PrivateBank loans with six HUD loans totalling US$37.7 million. Consequently, EHSI has utilized approximately US$572 million of its US$585.0 million overall limit. As at December 31, 2013, EHSI had 57 unencumbered centers with an estimated value of between US$250 million and US$300 million, which includes 19 centers that are leased to a third-party operator in Kentucky.

In July 2012, EHSI prepaid US$10.3 million of HUD-insured mortgages with a weighted average interest rate including MIP of 5.77% and closed on new HUD-insured mortgages totalling US$11.2 million with a weighted average interest rate including MIP of 3.55%. A loss on refinancing and retirement of debt of $0.8 million (US$0.8 million) was recorded in the 2012 third quarter associated with this refinancing.

EHSI Credit Facility

In 2012, EHSI entered into a new US$100.0 million senior secured revolving credit facility with a three-year term to June 2015 with floating-rate interest based on a pricing grid, to replace its US$70.0 million credit facility that matured in June 2012. This new credit facility consists of a US$80.0 million real estate based facility that was finalized in June 2012, and a US$20.0 million accounts receivable based credit facility that was finalized in September 2012. References to "EHSI Credit Facility" in this report mean either the new US$100.0 million line of credit entered into in 2012, or the former US$70.0 million line of credit that matured in June 2012, as the context requires.

The maximum amount available to be borrowed under the US$80.0 million portion of the EHSI Credit Facility is determined based on the lesser of: (i) 50% of the appraised values of the 20 skilled nursing centers collateralizing the EHSI Credit Facility; or (ii) an amount based on the actual net cash flow of these centers for the last 12 months. As at December 31, 2013, the maximum amount available under the real estate based facility was US$66.4 million. The maximum amount available to be borrowed under the US$20.0 million portion of the EHSI Credit Facility is based upon 80% of eligible receivables that are less than 90 days old. As at December 31, 2013, the maximum amount available under the accounts receivable based facility was US$20.0 million.

As at December 31, 2013, we had drawn US$2.1 million on the EHSI Credit Facility and had issued US$8.3 million under letters of credit, leaving US$76.0 million of the maximum available, subject to leverage requirements. At EHSI's option, the interest rate is either the eurodollar rate, with a floor set at 1%, plus a margin from 4% to 4.50%, or the U.S. prime rate plus a margin from 3% to 3.50%, with the specific margin based on EHSI's consolidated leverage ratio as defined in the EHSI Credit Facility. The interest rate at December 31, 2013, was 5.50% (December 31, 2012 – 5.25%).

For further information on the U.S. and Canadian refinancings, refer to *note 14* of the 2013 consolidated financial statements.

2012 Kentucky Lease Transaction

In May 2012, EHSI entered into an agreement to lease all 21 of its skilled nursing centers in the State of Kentucky (1,762 beds) to an experienced third-party long-term care operator based in Texas that operates through its affiliates in a number of other states. Nineteen of these centers (1,545 beds) were leased effective July 1, 2012, and the remaining two centers (217 beds) were leased effective October 1, 2012. Under the agreement, the operating leases have 10-year terms with two 5-year extensions at the option of the operator. In addition, if certain conditions are met, the operator has the option to purchase all of the centers during the initial lease term at agreed-upon per bed amounts. As a result of this transaction, EHSI no longer operates skilled nursing centers in Kentucky. The decision to exit the State of Kentucky is consistent with Extendicare's continuing strategy for achieving ongoing performance improvements, which includes the divestiture of operations that impede growth or create undue risk exposure. According to the *2013 AON Long Term Care General Liability and Professional Liability Actuarial Analysis,* the loss rate per occupied bed (limited to US$1.0 million per occurrence) in Kentucky has increased from US$2,220 per bed in 2005 to US$7,350 per bed in 2012.

During 2012, we recorded a pre-tax loss in connection with this transaction of $3.6 million (US$3.6 million), of which $2.6 million was recorded in the 2012 second quarter and $1.0 million in the 2012 third quarter. For the six months ended June 30, 2012, during which time all 21 Kentucky centers were still operated by EHSI, they generated annualized revenue of US$135.2 million and Adjusted EBITDA of US$18.2 million, including an allocation of US$12.0 million in provisions made for self-insured liabilities. Based on these annualized results, the estimated impact of the lease transaction was a reduction in Adjusted EBITDA of approximately $3.2 million per annum and a reduction in AFFO of approximately $0.6 million or $0.007 per share per annum.

For further information, refer to *note 9* of the 2013 consolidated financial statements.

Divestitures and Disposal Group Held for Sale

Extendicare continually assesses the performance of its asset portfolio, and for those assets that fail to meet operating and financial standards, a decision may be made to dispose of the asset. Assets to be disposed of are recorded at the lower of the carrying value or estimated fair value net of disposal costs. For further information, refer to *note 8* of the 2013 consolidated financial statements.

2013 ACTIVITY

As at December 31, 2013, Extendicare had assets, net of liabilities, held for sale with a net book value of $20.1 million consisting of 11 U.S. skilled nursing centers held for sale in various states and one closed nursing center in Washington.

In December 2013, EHSI decided to sell 11 skilled nursing centers located in various states due to poor operational performance and the need for future capital expenditures. The assets and liabilities of these nursing centers, totalling $36.2 million (US$34.0 million) and $16.3 million (US$15.4 million), respectively, were reclassified to assets and liabilities held for sale, respectively. EHSI expects to complete the sale of these centers within the next 12 months. In December 2013, we recorded an impairment charge of $7.3 million (US$6.8 million) to reduce the net book value of the properties to their estimated fair value net of disposal costs.

During 2013, we sold three properties for $3.7 million, one in Alberta and two in Ontario, that had been closed following our completion of three newly built centers in the same communities.

2012 ACTIVITY

As at December 31, 2012, Extendicare had assets, net of liabilities, held for sale with a net book value of $2.6 million consisting of two closed nursing centers in Washington and Alberta, and two Ontario nursing centers that were closed upon completion of new centers in 2013.

In January 2012, EHSI finalized and closed on the sale of its group purchasing organization, or GPO, for cash proceeds of US$56.0 million, resulting in a pre-tax gain of $56.5 million (US$55.7 million), or an after-tax gain of $35.0 million (US$34.5 million). An agreement in principle had been reached in December 2011 between EHSI and Navigator Group Purchasing, a subsidiary of Managed Health Care Associates, Inc., resulting in the reclassification of our U.S. GPO operations to discontinued operations at the end of 2011.

Economic Environment

The global and U.S. economy has had an indirect impact on the long-term care industry since the 2008 downturn due to the unprecedented loss of jobs in the U.S., reduction of health care benefits along with the loss of disposable income for elective health care services. As a result, there has been a reduction in admissions to our U.S. nursing centers and a concerted effort by federal, provincial and state governments to restrain or reduce funding of health programs. In response to the economic environment, Extendicare has undertaken several courses of action to minimize risks and maintain liquidity, including:

- reducing growth projects along with divestiture of underperforming assets and non-core businesses;
- implementing significant cost reduction initiatives;
- refinancing a significant portion of long-term debt with low-cost government-insured mortgages;
- monitoring cash usage; and
- maintaining solid banking relationships.

For the near term, there are no indications that the economy and economic risks affecting the industry are improving. Therefore, Extendicare plans to continue to monitor and implement steps to address these challenges. Below is a summary of the past and future uncertainties and significant risks that could have a material impact on Extendicare and its subsidiaries.

STATE, PROVINCIAL AND FEDERAL FUNDING AND REGULATORY PRESSURE

Reductions in Medicaid, Medicare and provincial funding for long-term care due to the economic downturn could have a material adverse effect on our earnings. Our business is highly labour intensive, with labour costs representing approximately 73% of our consolidated operating costs for 2013 (2012– 74%). As a result of resident care needs and regulatory requirements, we have limited ability to reduce or manage our labour costs. In addition, any escalation of regulatory pressure by CMS, state or provincial level government agencies could have a negative impact on our operating costs and thereby reduce our earnings.

A number of states in which we operate have faced severe budgetary shortfalls, resulting in reductions in Medicaid funding or increases at rates below inflation. The temporary increase in funding for state Medicaid programs, through the federal medical assistance percentage, or FMAP funding increase, ended on June 30, 2011. As a result, a number of states are facing considerable financial pressures that could result in future Medicaid rate reductions, despite some economic improvement in certain regions.

Effective October 1, 2011, CMS implemented reductions in Medicare funding to skilled nursing centers, along with other changes (referred to as the "2011 CMS Final Rule"), that we estimate have reduced EHSI's revenue and EBITDA by approximately US$64 million on an annualized basis. We have taken measures to help mitigate the adverse effect of the elimination of group therapy and the assessment process changes, such as employing more therapists and improving productivity. In addition, EHSI took action to reduce operational and corporate office staff and realize savings in supplies, drugs, and third-party service arrangements with vendors, the majority of which were implemented by October 1, 2011, and the balance by the beginning of 2012. We estimate that these savings reduced EHSI's general, administrative and non-wage operating costs by approximately US$24 million on an annualized basis. None of these cost saving measures involved a reduction of direct care staffing at our centers. Therefore, we estimate that the net negative effect of the 2011 CMS Final Rule on our Adjusted EBITDA, partially offset by our cost saving initiatives, was approximately US$40 million on an annualized basis.

A more detailed discussion of recent developments impacting Medicare and Medicaid rates is provided under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

DECLINE IN OCCUPANCY IN THE U.S.

Our average skilled nursing center occupancy rates have declined from 86.0% in 2010 to 82.9% in 2013, due to the reasons discussed below. However, due to the implementation of programs to attract short-term rehabilitation residents, our Skilled Mix census as a percentage of our total skilled nursing center census has remained unchanged at 22.1% in each of 2010 and 2013.

The global economic downturn that began in 2008 and the continuing slow recovery have reduced disposable income of individuals, reduced employment and resulted in a general restraint by the public on health care spending. We believe that the decline we have experienced in Medicare and total admissions was in part due to individuals deferring hospital elective surgery due to the economy and the resulting reduction in required post-acute care. Our future earnings could be eroded further should the level of admissions decrease as a result of a reduction in the financial resources or health insurance coverage of our prospective residents.

Another reason for the decline in skilled nursing center occupancy levels has been the concerted effort by state Medicaid programs to increase the level of care thresholds and to shift potential nursing center residents to home care programs and assisted living centers. In addition, Managed Care organizations have increasingly focused on reducing the period of coverage in skilled nursing centers and on seeking alternative lower care options for their clients, in order to reduce costs to the Medicaid program.

In response to the decline in short-term admissions in the U.S., we have refocused and refined our strategic marketing plans, are working on strategic alliances within the marketplaces in which we operate, and have invested to increase the number of rehabilitation suites within our portfolio to increase our market share in communities where we anticipate returns on our investments that meet our criteria. Included in these initiatives is the establishment of ALTUs, which are upgraded suites within our centers targeted to attract short-term rehabilitation residents. Since launching the program in 2009, we have completed 17 ALTUs and have two additional ALTUs under construction, with plans to continue to expand the number of ALTUs.

UPDATE OF REGULATORY AND REIMBURSEMENT CHANGES AFFECTING REVENUE

We operate in a competitive marketplace and depend substantially on revenue derived from government sources, with the remaining revenue from commercial insurers, managed care and private individuals. Ongoing pressures from government programs, along with other health care payors seeking to control costs and/or limit reimbursement rates for medical services, are a risk to us. Government agencies have steadily increased their enforcement activity over the past several years. As a result, in addition to increasing resources to improve the quality of services provided to our residents, we are continually allocating increased resources to ensure compliance with applicable laws and regulations and to respond to inspections, investigations and/or enforcement actions. Our costs to respond to and/or defend surveys, inspections, audits and investigations are significant and are likely to increase in the current environment.

Non-compliance with applicable laws and licensure requirements governing long-term care could result in adverse consequences, including severe penalties, which may include criminal sanctions and fines, civil monetary penalties and fines, administrative and other sanctions, including the exclusion from participation in the Medicare and Medicaid programs, or one or more third-party payor networks. We may be required to refund amounts that have been paid to us by federal, state and/or provincial funding programs. These penalties could have a material adverse effect on the business, results of operations or financial condition of Extendicare.

United States

The majority of Extendicare's operations are in the United States where 62.8% of its revenue from continuing operations was earned in 2013 (2012 – 64.2%). EHSI receives payment for its services and products from the federal (Medicare) and state (Medicaid) medical assistance programs, Managed Care organizations (including HMO and preferred provider organizations), commercial insurers, the Department of Veterans Affairs, as well as from private payors. During 2013, approximately 49% of our U.S. resident admissions were Medicare funded and approximately 34% were Managed Care funded.

MEDICARE FUNDING

Market Basket Annual Increases

Changes in Medicare funding levels typically occur on October 1st of each year to coincide with the federal government's fiscal year. Notwithstanding the implementation of MDS 3.0 and RUG-IV in October 2010, and the 2011 CMS Final Rule, Medicare funding changes generally represent an inflationary increase for the Medicare Part A funding, otherwise referred to as a "market basket" increase. In addition, Medicare increases are also periodically adjusted for "forecasting errors" that are identified by CMS based upon filed cost reports.

The net market basket increase implemented on October 1, 2013, was 1.3%, consisting of a market basket increase of 2.3% minus a forecasting error of 0.5% and a productivity adjustment of 0.5%. We estimate that the impact of this funding increase will provide us with additional Medicare Part A and Managed Care revenue of approximately US$5.1 million per annum. In comparison, the October 2012 net market basket increase was 1.8%, which consisted of a market basket increase of 2.5% minus a productivity adjustment of 0.7%. The estimated impact of this 1.8% rate increase was additional Medicare Part A and Managed Care revenue to us of approximately US$7.2 million per annum.

As previously reported, sequestration triggered automatic Medicare funding cuts of 2% effective April 1, 2013. Sequestration will remain in effect through to 2023, unless there are future legislative changes. We estimate that this 2% funding cut has reduced our Medicare and Managed Care revenue by approximately US$6.3 million per annum. For further information refer to the discussion below under the heading "The American Taxpayer Relief Act of 2012".

Consolidated Appropriations Act of 2014

On January 17, 2014, the U.S. President signed into law the *Consolidated Appropriations Act of 2014,* which provides fiscal year 2014 appropriations for all projects and activities of the U.S. federal government. This law did not make any significant changes to Medicare or Medicaid programs but provides funding for existing programs.

Pathway for SGR Reform Act of 2013

On December 26, 2013, the U.S. President signed into law the SGR Act. This law postpones an estimated 27% cut to the MPFS rates through March 31, 2014. Passage of this short-term extension, often referred to as the "Doc Fix", averts cuts to Part B therapy rates received by EHSI amounting to an estimated US$11 million per annum. Proposals for a more permanent solution are currently pending. The SGR Act also called for a 0.5% increase in the Part B fee schedule rates through April 1, 2014.

The SGR Act extends through March 31, 2014, the process for granting exceptions to the monetary caps on Medicare coverage of physical therapy, speech-language pathology, and occupation therapy services.

The SGR Act also extends by two years, from 2021 to 2023, the 2% sequestration funding reductions enacted by the *Budget Control Act of 2011* (see below).

The American Taxpayer Relief Act of 2012

On January 2, 2013, the U.S. President signed into law the ATRA, which included the following:

- A delay until January 1, 2014, of a 27% reduction in Medicare Part B rates previously scheduled to have commenced on January 1, 2013, pursuant to the *Middle Class Tax Relief and Job Creation Act of 2012* (see below). Historically, the rate cuts have been suspended for one-year periods. However, if implemented, the impact of the 27% Part B rate reduction on EHSI's therapy revenue was estimated to be US$11 million per annum.
- A delay until April 1, 2013, of a 2% cut in Medicare Part A funding previously scheduled to have commenced on January 2, 2013, pursuant to the sequestration clause of the *Budget Control Act of 2011* (see below). EHSI estimates that the 2% cut will reduce annual Medicare and Managed Care revenue by approximately US$6.3 million. The 2% reduction applies to net Medicare Part A, Medicare Part B, and HMO RUGs-based payments, after a reduction for co-insurance and deductibles.
- A decrease in reimbursement for Medicare Part B services due to an increase in the MPPR percentage from 25% to 50% effective April 1, 2013. EHSI estimates that this reduction will reduce annual therapy revenue by approximately US$3.6 million. CMS had previously implemented a 25% reduction for residents receiving multiple therapies in the same day.
- An extension of the therapy caps exception process through December 31, 2013 (see "Therapy Caps" below). This exception process allows for automatic exceptions to annual caps set by CMS for Part B therapy services for individuals who are able to prove medical necessity for the therapy. For 2013, these annual caps are US$1,900 for physical and speech therapy and US$1,900 for occupational therapy. For 2012, these annual caps were US$1,880.
- An extension through December 31, 2013, of the required manual medical review for pre-approval for annual therapy charges in excess of US$3,700 for occupational therapy and US$3,700 for physical and speech therapy combined.
    a. Effective January 1, 2013, the manual medical review pre-approval process was replaced by a mandatory Additional Development Request (ADR) pre-payment review process for billed services at or above the US$3,700 threshold.
    b. Beginning April 1, 2013, all billed claims at or above the threshold will be subject to either pre-payment or post-payment review, depending upon state location.

Budget Control Act of 2011 and Sequestration

On August 2, 2011, the U.S. President signed the *Budget Control Act* (BCA) as passed by the House of Representatives and Senate. The BCA brought significant change to the federal budget process by forcing significant cuts to future federal spending while raising the national debt limit. Following months of negotiations and facing default, a process was put into place to reduce the federal deficit. The BCA imposed caps on discretionary spending starting October 1, 2011, intended to generate US$917 billion in savings over the next 10 years. It also put into place a process to find another US$1.2 trillion to US$1.5 trillion in deficit reductions over the next 10 years. While caps on discretionary spending were put into place, the BCA did not specifically make hard policy choices on how to implement cuts. It was left up to Congress and a special bipartisan and bicameral committee to establish policy. The BCA did not make any changes to entitlements but rather imposed caps on spending. To comply with the law, Congress was to have reduced spending by about US$25 billion for the budget cycle starting in October 2011.

The Special Joint Select Committee on Deficit Reduction, referred to as the "Super Committee" was to propose legislation no later than January 15, 2012, to reduce spending by the additional US$1.2 trillion. As the Super Committee was unable to make a recommendation and U.S. Congress failed to pass legislation, a process of sequestration was scheduled to have automatically reduced Medicare funding by 2% beginning January 2, 2013. The implementation of these spending cuts was delayed until April 1, 2013, by the ATRA, as discussed above.

The Middle Class Tax Relief and Job Creation Act of 2012 – Reduction in Reimbursable Bad Debts

On February 22, 2012, the U.S. President signed the *Middle Class Tax Relief and Job Creation Act of 2012* (H.R. 3630) which implemented the following changes:

- Prevented a 27% cut in Medicare physician rates proposed by CMS to begin on March 1, 2012, and instead froze payment rates at their current level until December 31, 2012. These cuts were subsequently delayed until January 1, 2014, by the ATRA, as discussed above.
- Extended the therapy caps exception process through December 31, 2012. This process was later extended through December 31, 2013, by the ATRA, as discussed above.
- Reduced reimbursement for bad debts for dually eligible beneficiaries (Medicare and Medicaid eligible) from 100% to 88% in calendar year 2013, 76% in calendar year 2014 and ultimately to 65% in calendar year 2015. For dually eligible residents, who qualify as such because they lack the resources to pay their Part A co-insurance amounts, long-term care operators bill the Medicaid program for unpaid amounts. In certain states, the Medicaid program reimburses the operator for unpaid amounts, whereas if they do not, the operator can obtain reimbursement through the Medicare program by submitting unpaid claims through their annual filing of cost reports. In the majority of states where EHSI operates, the Medicaid program does not reimburse its centers for unpaid Part A co-insurance and, therefore, EHSI files for reimbursement of approximately US$16 million per annum in reimbursable bad debts. This is essentially cutting the Medicare rates of the nursing centers upon commencement of the co-insurance period, being the 20th day of the resident's stay. The reduction in reimbursement for bad debts reduced EHSI's revenue by US$1.3 million in 2012 (for transitional adjustments) and by US$2.7 million in 2013. It is expected to reduce EHSI's revenue by US$4.5 million and US$5.8 million in 2014 and 2015, respectively. Separately, EHSI obtains reimbursable bad debts for non-dually eligible Part A co-insurance bad debts of approximately US$0.6 million, which is currently reimbursed at 65%.

Therapy Caps

In 2006, CMS implemented a cap on Part B therapy services for physical and speech therapy and another cap for occupational therapy. However, lobbying efforts have been successful in preventing the full implementation of the CMS caps through U.S. Congressional action that established exceptions for individuals who were able to prove medical necessity for the therapy. Effective January 1, 2014, the SGR Act extended through to March 2014, the CMS caps on Part B therapy services for physical and speech therapy at US$1,920 and for occupational therapy at US$1,920, and also extended the automatic exception if the therapy services are considered medically necessary.

Effective October 1, 2012, CMS established a new medical review process for annual claims over US$3,700 for physical and speech therapy and a second medical review process for annual claims over US$3,700 for occupational therapy. The SGR Act has extended this review process until March 31, 2014. EHSI has recorded negative revenue adjustments for denials of therapy services provided in excess of these caps as follows: US$0.1 million, US$0.6 million, US$0.4 million, and US$1.2 million, in each quarter of 2013, respectively; as well as US$1.0 million in the 2012 fourth quarter.

2010 Health Care Reform Legislation Remains a Significant Factor

In March 2010, historic health care reform legislation, the *Patient Protection and Affordable Care Act* (H.R. 3590) (PPACA), was enacted into law at a cost of US$940 billion over 10 years. Amendments to the PPACA were enacted into law on March 30, 2010, with the passage of the *Health Care Education Affordability Act* (HCEAA). In June 2012, the U.S. Supreme Court upheld the constitutionality of most of the provisions of the PPACA and the re-election of the U.S. President in November 2012 eliminated the possibility of the PPACA being repealed. On July 2, 2013, the U.S. Department of Treasury announced that the effective dates of various provisions of the PPACA will be delayed from 2014 to 2015 to give the government and industry additional time to effectively implement these provisions due to their complexity. This delay includes the "employer mandate" that requires employers with more than 50 employees to provide health care insurance to all full-time employees or pay an employer tax (see below). In February 2014, the employer mandate for organizations with between 50 and 99 employees was further amended to delay the requirement until 2016. The U.S. Congress is considering various proposals to confirm the delay of these provisions and to also make other changes.

The PPACA requires all individuals to have a minimum level of health care coverage (the "individual mandate") and the employer mandate requires employers to provide health care coverage, with certain stipulations, for employees. The legislation increases the number of individuals with health care insurance coverage by mandating that all individuals obtain coverage by 2014 through their employer or directly through insurance companies or marketplace "exchanges". The employer mandate has been delayed until January 1, 2015 (for employers with 100 or more employees), or January 1, 2016 (for employers with between 50 and 90 employees), at which time, all employers will have to either offer health care insurance for all full-time employees or pay an employer tax. For employers that offer coverage, the health care plan must provide a minimum value coverage and the employee's portion of the coverage must be affordable based upon the employee's income. For employers that offer such insurance, the employee has the right to opt out and either obtain alternative health insurance from the "health care exchanges" or pay an individual tax. As an alternative, the employer can opt out of providing coverage for its employees and be subject to an employer tax, in which case the employees would obtain their health insurance from the health care exchanges.

EHSI currently offers health care coverage to all of its qualifying employees under several different programs tailored to meet an individual's budget and risk tolerance. Approximately 65% of EHSI's employees have joined one of EHSI's programs. To date, there has not been any material impact from the legislation on our health plan costs as a result of certain plan changes that we have implemented. However, it is difficult to determine, based upon anticipated changes in the legislation, what future changes may have to be made. At the present time, EHSI plans to continue to offer its health plan coverage to all of its full-time employees. However, it is difficult to quantify whether more employees will enrol in the plan and, therefore, EHSI cannot determine the future financial impact of the legislation.

The other key aspects of the legislation that are specific to and impact long-term care providers, among other aspects, are as follows:

(i) a productivity adjustment to Medicare rates commencing October 1, 2011, that will reduce the annual market basket increases by approximately 1%, representing a reduction in Medicare funding of US$14.6 billion over a 10-year period. We anticipate that the annual impact from this Medicare reduction in rates to be approximately US$5 million per annum;

(ii) new transparency requirements and additional employee background check requirements for nursing centers;

(iii) the creation of a new Independent Medicare Payment Advisory Board that will make recommendations to U.S. Congress on Medicare payment rates for health care providers, including skilled nursing centers; and

(iv) a mandate for CMS to create a national, voluntary pilot bundling payment program by 2013.

The additional following provisions were included in the final act:

(i) language that requires MedPAC to take Medicaid into consideration during its analyses for providers, including skilled nursing and home health;

(ii) a federal mandate for states to expand home and community-based services with increased FMAP to states that rebalance spending between institutional and community-based care by October 1, 2015;

(iii) the U.S. Department of Health and Human Services must submit a Medicare value-based purchasing plan for skilled nursing centers by October 1, 2011; and

(iv) as of July 1, 2011, Medicaid will no longer provide payments to states for services related to health care acquired conditions, including conditions acquired in other than hospital settings.

In October 2011, CMS issued final rules on the establishment and operation of Accountable Care Organizations (ACOs). The primary purpose of ACOs is to help doctors, hospitals, and other health care providers better coordinate care for Medicare patients and to provide a more cost effective and integrated health care system. ACOs create incentives for health care providers to work together to treat an individual patient across care settings – including doctor's offices, hospitals, and long-term care centers. The Medicare Shared Savings Program will reward ACOs that lower growth in health care costs while meeting performance standards on quality of care and putting patients first. Patient and provider participation in an ACO is purely voluntary.

At this point in time, U.S. organizations are not able to predict the final form of the health care reform changes and therefore management is not able to clearly quantify the impact of such on the business, results of operations and financial condition of Extendicare. Management intends to closely analyze the legislation and any subsequent amendments, and proactively respond in a manner with a view to taking advantage of new opportunities and minimizing EHSI's exposure to new risks.

MEDICAID FUNDING

The decline in state tax revenue and increased demand for unemployment and Medicaid services, as a result of the economic downturn, has put state Medicaid budgets under considerable strain. Many states have implemented or expanded their provider tax programs (a tax imposed on providers of long-term care) as a means to increase the levels of funding contributed by the federal government to their Medicaid programs. However, these additional federal funds have only partially mitigated funding cuts of some of the states. Our respective federal and state health care associations have lobbied vigorously for continuation of consistent funding in the sector.

Annual Medicaid Rate Changes

With respect to the 11 states in which EHSI operates skilled nursing centers, annual Medicaid rate changes are effective on July 1st in seven of the states (Idaho, Indiana, Ohio, Oregon, Pennsylvania, Washington and Wisconsin); on October 1st in three of the states (Michigan, Minnesota and West Virginia); and on January 1st in Delaware.

The July 1, 2013, Medicaid rates have been issued for all seven states noted above. The net Medicaid funding for these states, defined as Medicaid rates less provider taxes, increased by approximately 0.2%, or US$0.9 million on an annualized basis. The October 1, 2013, net Medicaid funding changes for Michigan, Minnesota and West Virginia increased by approximately 2.8%, or US$3.5 million on an annualized basis. The January 1, 2013, net Medicaid funding for Delaware decreased by approximately 1.0%, or less than US$0.1 million on an annualized basis.

The average of the net Medicaid funding changes effective in 2013, as of the respective dates for all 11 states in which EHSI operates, is estimated to be an increase of 0.8%, or US$4.4 million on an annualized basis (2012 – net increase of 3.2%, or US$15.8 million, excluding Kentucky). This estimate could be impacted by CMI changes and Medicaid occupancy changes, along with other factors.

Canada

In Canada, provincial legislation and regulations closely control all aspects of operation and funding of nursing centers, including the fee structure, the adequacy of physical centers, standards of care and accommodation, equipment and personnel. In some provinces, the government has delegated responsibility for the funding and administration of long-term care programs to regional health authorities.

In most provinces, a license must be obtained from the applicable provincial ministry of health in order to operate a nursing center. Currently, there is almost a universal restriction upon the issuance of new licenses across the country because of the funding implications for governments. In addition to the license procedure, or in some cases in place of, operators in Alberta, Manitoba and Ontario are required to sign service contracts that incorporate service expectations with the provincial government or regional health authority. These contracts specify the services to be provided and the remuneration to be received. Nursing center licenses and service contracts are subject to annual renewals and do not represent any guarantee of continued operation beyond the term of the license or contract. However, Ontario's new *Long-Term Care Homes Act, 2007* (the "LTC Act 2007"), that was proclaimed into force on July 1, 2010, provides for, among other things: new licensing procedures that include more rigorous standards for license review (including public hearings); fixed license terms of up to 25 years, after which a new license may or may not be issued; the revocation of a license for continued non-compliance; more onerous duties imposed on long-term care operators; unannounced annual inspections; and a more comprehensive enforcement regime. Long-term care operators will be given notification of whether or not a new license will be issued at least three years before the end of the license term.

The fees charged by ECI for its Canadian nursing centers and home health care services are regulated by provincial authorities, and a substantial portion of these fees are funded by provincial programs, with the remainder paid for by the residents or private home health care clients. Each province has a different system for managing the services provided. As a result, there can be significant variability in the regulations governing the provision of and reimbursement for care from location to location.

Ontario is ECI's largest market for both its long-term care and home health care services. Funding for Ontario long-term care centers is based on reimbursement for the level of care assessed to be required by the residents, in accordance with scheduled rates. The MOHLTC allocates funds through "funding envelopes", specifically: nursing and personal care; programs and support services; and accommodation (which includes a sub-envelope for food). The funding for the nursing and personal care envelopes is generally adjusted annually based on the acuity of residents as determined by a classification assessment of resident care needs. The nursing and personal care, programs and support services, and food envelopes are "flow-through" envelopes, whereby any deviation in actual costs from scheduled rates is either absorbed by the provider (if actual costs exceed funding allocations) or is returned to the MOHLTC (if actual costs are below funding allocations). With respect to the accommodation envelope, providers retain any excess funding received over costs incurred. The province sets the rates for standard accommodation, as well as the maximum amounts that a provider can charge for semi-private and private accommodation (preferred accommodation). The provider is allowed to bill and retain the premiums charged for preferred accommodation. The accommodation rates are substantially paid for by the resident; however, the province guarantees funding for standard accommodation through resident subsidies. Overall funding is occupancy-based, but once the average occupancy level of 97% or higher is achieved, operators receive funding based on 100% occupancy. In 2011, the MOHLTC implemented an occupancy protection program for occupancy levels below 97%, and extended this in fiscal 2012 and 2013. The MOHLTC has not indicated whether it plans to extend the occupancy protection in fiscal 2014. Under the occupancy protection program those with occupancy levels of between 90% and 94% receive funding based on their actual occupancy plus 1% and those with occupancy levels of between 94% and 97% receive funding based on their actual occupancy plus 2%. ECI's Ontario nursing centers averaged 97.7% occupancy in total during 2013, with only one of its centers averaging slightly below 97%.

ONTARIO REDEVELOPMENT PROGRAM

In Ontario, the MOHLTC announced plans in 2007 to redevelop 35,000 older long-term care beds in five phases over 15 years. The first phase of the renewal strategy was launched in April 2009 with the release of the policies and a call for applications for redevelopment. Qualified applicants are eligible for a construction funding subsidy over 25 years that starts at $13.30 per bed per day for large centers of 100 beds or more. Existing centers to be renovated are eligible for relaxed retrofit standards at a reduced construction funding subsidy. Leadership in Energy and Environmental Design (LEED) construction standards must be met, and a $1.00 premium is provided to those centers achieving LEED Silver status.

The overwhelming majority of operators believe that the level of capital funding is insufficient given the current costs of construction and the new design standards, and have expressed their concerns to the government. In response, the MOHLTC commenced a review of the program in 2011, and we are awaiting a report on its recommendations and or proposed changes to the program. Should operators choose not to replace their centers, it could have a significant impact on the number of nursing center beds in the province, which will offer both risks and opportunities for others in the marketplace.

Under the first phase of the MOHLTC's redevelopment program launched in 2009, ECI completed the redevelopment of 382 class "C" beds through the construction of two new nursing centers (refer to "Other Significant Developments – Development Projects"). ECI owns 21 nursing centers with 3,287 class "C" beds in Ontario, which are under review by management to determine their priorities for redevelopment once the government reinitiates its redevelopment program. Should ECI decide to rebuild or renovate all of its remaining class "C" beds, management estimates that the total capital outlay will be in the range of $375 million to $475 million, depending on a number of factors including the cost of construction and prescribed design standards. Management estimates that approximately 20% to 25% of the total cost will be required to be funded by equity.

ONTARIO LONG-TERM CARE FUNDING

All Ontario long-term care centers have implemented a new resident assessment instrument – minimum data set, or RAI-MDS. In April 2010, the MOHLTC began using the RAI-MDS 2.0 version to drive a new case-mix classification methodology using 34 categories under a RUGs-based funding model. This RUGs model will tie resident needs to costs of care in a more impartial and transparent way. In order to facilitate funding stability in the long-term care sector during the implementation process of the new funding model and to prevent unsustainable swings in funding, the MOHLTC implemented a 5% CMI corridor in 2012 and will continue with this funding scheme for all centers during fiscal 2014/2015.

On April 1st each year, the MOHLTC generally provides flow-through funding adjustments on the government funded portion of the fees. In 2013, funding increases of approximately 2% were received in the flow-through envelopes effective April 1, 2013, along with our CMI adjustments. These enhancements are estimated to provide additional revenue to ECI of approximately $3.6 million to offset additional costs for resident care and services within the nursing and program envelopes (April 2012 – $1.5 million).

On July 1st each year, the MOHLTC generally implements annual accommodation funding increases to the per diem rates provided to long-term care providers. The July 1, 2013 funding enhancements increased the daily rates for food costs by $0.12 and the non-flow-through component of the accommodation envelope by $0.59. ECI estimates that this enhanced funding increased its annual revenue by approximately $1.3 million (July 2012 – $2.4 million).

In addition, the MOHLTC introduced modest increases to the preferred accommodation premiums on each of July 1, 2012 and July 1, 2013, of $1.00 per day for semi-private accommodation and $1.75 per day for private accommodation, bringing the maximum preferred accommodation premiums to $10.00 per day for semi-private and $21.50 per day for private. These increases are only applicable to newly admitted residents to beds that are classified as "New" or "A" beds. Residents of "B" and "C" beds will continue to pay the lower daily preferred accommodation premiums of $8.00 for semi-private accommodation and $18.00 for private accommodation. As at December 31, 2013, ECI had 13 "New" nursing centers (1,847 beds) in Ontario of which 1,106 of the beds offered preferred accommodation in the form of private rooms. We will benefit from this premium increase for preferred accommodation over time as new residents are admitted.

In October 2012, the MOHLTC announced changes that will improve the funding and related managerial flexibilities to all long-term care providers. Prior to this change, long-term care providers refunded to the MOHLTC underspent amounts, or conversely absorbed the loss of any overspent amounts, for each of the flow-through envelopes separately. Effective January 1, 2013, long-term care operators will be able to use underspent funds in the nursing or program envelopes to offset pressures in any other flow-through envelope. Extendicare has successfully managed to control its spending under the flow-through envelopes in the past; however, we welcome these changes. In addition, the MOHLTC implemented changes with respect to funding for high-intensity needs, which was previously provided on an application and cost reimbursement basis, and has provided additional funding to cover increased costs of care. Effective January 1, 2013, the daily rates to the flow-through envelopes increased by $1.03, which ECI estimates will increase its annual revenue and operating costs by approximately $1.9 million.

In response to the economic downturn, in 2010 the Ontario government implemented a wage freeze for labour contracts being renewed over the next two years, and indicated its expectation that this should be extended to the government-funded long-term care sector, by announcing that it would not provide funding for any wage increases. As part of the Ontario government's 2012 budget (the "2012 Ontario Budget"), the government has maintained the wage freeze for another two years, and is asking the broader public sector to do the same. The government indicated that it expects existing union contracts will be left intact, and new collective agreements to be negotiated over the next two years should not allow for increases in compensation. The 2012 Ontario Budget states that where agreements cannot be reached that are consistent with the government's plan, the government is prepared to propose necessary administrative and legislative measures. However, since 2010, arbitrators have awarded increases to union wages in the long-term care sector during this period. As a result, in some cases, the incremental cost of these arbitrated wage increases to ECI has exceeded the funding increases outlined above.

ALBERTA LONG-TERM CARE LEGISLATION AND FUNDING

In Alberta, a new activity-based funding system for continuing care centers commenced on April 1, 2010. However, AHS continues to adjust the formulas and the accountabilities. The funding model includes a separate pool for quality incentives funding (QIF) that represents a "quality bonus" awarded to centers meeting or exceeding a set of pre-determined quality criteria. The QIF program was implemented on April 1, 2011, and is subject to further development as quality information and indicators become available. To date, the QIF program has consisted of four pre-determined indicators that are used to determine an operator's eligibility for 0.2% of its government funding. The quality indicators may include such things as: family satisfaction survey results; accreditation status; immunization rates; medication reconciliations; and the implementation of quality improvement initiatives based on the RAI-MDS indicators.

Effective April 1, 2013, the Alberta government provided funding increases to long-term care providers that included an inflationary funding increase of approximately 2.5%, together with adjustments for CMI, occupancy and other factors. ECI estimates that its funding has improved by an average of 2.1% representing annual revenue of approximately $1.6 million (April 2012 – $4.0 million).

Effective January 1, 2013, the Alberta government provided a 5% increase in the long-term care accommodation fees (the portion paid directly by the residents), to recognize the rising costs of delivering accommodation and related services. The last time the accommodation fees increased was in February 2011 at a rate of 3%. ECI estimates that the 5% increase in 2013 will contribute additional annual revenue of approximately $1.3 million.

ONTARIO HOME HEALTH CARE LEGISLATION AND FUNDING

ECI is a major private-sector provider of home health care services in Ontario through ParaMed. Prior to August 2013, ParaMed also operated in Alberta, where approximately 4% of its annual revenue was generated. ParaMed no longer provides services in Alberta as a result of the outcome of an AHS initiative to reduce the number of service providers in the province.

In 2004, the MOHLTC froze the Ontario home health care competitive bidding process for contracts while it undertook a study to improve the procurement model, and during this period, existing contracts were extended. In October 2012, the MOHLTC implemented a new model for home health care that does not involve a bidding process. All CCAC home health care contracts within the province concluded on September 30, 2012, and new open-ended, flexible CCAC home health care contracts commenced on October 1, 2012. ParaMed signed new open-ended contracts for all of its existing CCAC contracts. The agreements provide for six months' notice to providers for termination of a contract, and providers are to provide the CCAC with twelve months' notice of intention to give up a contract. The new service delivery model will place greater emphasis on quality of care and value than past arrangements, with service providers' performance evaluated based on these elements. Performance against an established set of indicators will guide decisions during future contract discussions.

Under the new model, funding will be outcome-based and designed to promote consolidated care for clients in order to address needs and realize improved outcomes. Integrated care for defined population groups (such as hip and knee replacement and wound care) has commenced in 2012 with a small number of clients, and will gradually expand as the service model is improved upon. The introduction of reimbursement for care in these consolidated pathways is anticipated but is not expected to begin before the end of 2014 at the earliest, and will be on the basis of outcomes achieved for these particular population groups. This is a change from the current service delivery model that is fee-for-service, based on client referrals for a single service, with a set number of visits and reimbursement based on each completed visit. Consequently, the new funding model will place greater emphasis on quality of care, value and outcomes, than past arrangements. A small number of CCACs are currently participating in a proof-of-concept period to test the model with select providers, including ParaMed.

ParaMed is evaluating the anticipated effect of these changes to its current operations, and is actively engaged in determining the necessary changes to internal operational processes and external opportunities required to prepare for the introduction of consolidated service client care. Specific strategies for growth in this evolving market remain unknown at the present time. However, in order to minimize disruption to the sector and therefore client care, an effort to maintain current market share of existing service providers throughout the transition to outcome-based care for defined population groups is anticipated. We expect that superior quality service delivery will ensure retention of our current volumes and will also drive opportunities for future growth.

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash *(thousands of dollars unless otherwise noted)*	**2013**	2012
Cash provided by operating activities, before working capital changes and interest and income taxes	**165,938**	198,848
Net change in operating assets and liabilities		
Accounts receivable	**6,246**	21,111
Other current assets	**4,541**	759
Accounts payable and accrued liabilities	**(15,882)**	(31,701)
	(5,095)	(9,831)
Interest and taxes paid		
Interest paid	**(59,585)**	(60,276)
Interest received	**4,657**	3,509
Income taxes paid	**(7,999)**	(23,463)
	(62,927)	(80,230)
Net cash from operating activities	**97,916**	108,787
Net cash used in investing activities	**(50,436)**	(33,143)
Net cash used in financing activities	**(25,464)**	(83,150)
Foreign exchange gain (loss) on U.S. cash held	**2,585**	(1,114)
Increase (decrease) in cash and short-term investments	**24,601**	(8,620)
Cash and short-term investments at beginning of year	**71,398**	80,018
Cash and short-term investments at end of year	**95,999**	71,398
Average U.S./Canadian dollar exchange rate	**1.0299**	0.9996

At December 31, 2013, Extendicare had cash and short-term investments of $96.0 million compared with $71.4 million at December 31, 2012, representing an increase of $24.6 million. Cash pledged of $18.7 million is excluded from our available cash balance as it relates to US$15.5 million held in escrow pursuant to the HUD regulatory agreements for working capital purposes, and US$1.3 million and $0.8 million designated for future capital expenditures in the U.S. and Canada, respectively.

Net cash from operating activities was a source of $97.9 million in 2013 compared to $108.8 million in 2012, representing a decrease of $10.9 million. The decline in earnings after cash interest and taxes paid was partially offset by a favourable net change in operating assets and liabilities between periods. The change in the operating assets and liabilities were favourable compared to the same period last year primarily due to the impact of timing of purchases and the payroll cycle on accounts payable and accrued liabilities.

Net cash used in investing activities was $50.4 million in 2013 compared to $33.1 million in 2012. The 2013 activity related primarily to expenditures for property, equipment and software. The 2012 activity reflected expenditures for property, equipment and software, partially offset by the sale of our U.S. group purchasing operations for net cash proceeds of $56.3 million.

Purchases of property, equipment and software were $55.8 million in 2013 compared to $84.1 million in 2012. Growth capital expenditures, excluding acquisitions, were $28.7 million this year compared to $49.2 million in 2012, and related to the construction of new beds, building improvements or capital costs aimed at earnings growth. Maintenance capital expenditures, which are the capital costs to sustain and upgrade existing property and equipment assets, were $28.2 million in 2013 compared to $35.7 million in 2012, representing 1.4% and 1.8% of revenue, respectively. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend between 1.5% and 2.0% of revenue annually on maintenance capital expenditures, which is consistent with our objective to maintain and upgrade our centers. We are projecting to spend in the range of $38 million to $43 million in facility maintenance capital expenditures and $15 million to $20 million in growth capital expenditures in 2014.

The following table summarizes the components of property, equipment and software expenditures.

Purchase of Property, Equipment and Software *(thousands of dollars unless otherwise noted)*	**2013**	2012
Growth Expenditures		
U.S. operations *(C$)*	**8,328**	7,343
Canadian operations	**20,419**	41,910
	28,747	49,253
Facility Maintenance		
U.S. operations *(C$)*	**20,157**	24,587
Canadian operations	**8,081**	11,136
	28,238	35,723
Deduct: capitalized interest	**(1,232)**	(873)
	55,753	84,103
Average U.S./Canadian dollar exchange rate	**1.0299**	0.9996

Net cash used in financing activities was $25.5 million in 2013 compared to $83.2 million in 2012. The 2013 activity related primarily to the payment of cash dividends of $45.5 million and financing costs of $2.1 million, partially offset by $5.4 million of debt issuances in excess of repayments, a decrease in investments held for self-insured liabilities of $6.9 million, and a $9.8 million release of restricted cash. In comparison, the 2012 activity included an increase of $31.6 million in investments held for self-insured liabilities, cash distributions of $57.0 million, financing costs of $13.1 million, and an $11.8 million increase in restricted cash, partially offset by $30.3 million of debt issuances in excess of repayments. For information on the change in long-term debt, refer to "Liquidity and Capital Resources – Long-term Debt".

Reconciliation of Net Cash from Operating Activities to AFFO

The following table provides a reconciliation of the net cash from operating activities to AFFO on a quarterly and annual basis for each of 2013 and 2012.[1]

	Q1		Q2		Q3		Q4		Year	
(millions of dollars)	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012	**2013**	2012
Net cash from operating activities	**24.0**	17.5	**21.9**	18.8	**27.6**	31.1	**24.4**	41.4	**97.9**	108.8
Add (Deduct):										
Net change in operating assets and liabilities, including interest and taxes	**(0.4)**	(6.1)	**(1.8)**	11.8	**(0.9)**	1.6	**12.8**	(1.9)	**9.7**	5.4
Current tax on fair value adjustments, gain/loss on foreign exchange, financial instruments, asset impairment, disposals and other items	**–**	21.3	**(0.2)**	(1.0)	**–**	(0.6)	**–**	0.1	**(0.2)**	19.8
Net provisions and payments for self-insured liabilities	**(1.7)**	(1.1)	**7.0**	(3.5)	**(1.6)**	(13.1)	**(15.5)**	0.8	**(11.8)**	(16.9)
Depreciation for FFEC	**(5.6)**	(5.8)	**(5.5)**	(6.3)	**(5.5)**	(5.7)	**(5.4)**	(5.8)	**(22.0)**	(23.6)
Principal portion of government capital funding payments	**0.7**	0.7	**0.9**	0.7	**0.9**	0.7	**0.9**	0.7	**3.4**	2.8
Additional facility maintenance capital expenditures[2]	**0.9**	1.0	**(0.3)**	(1.0)	**–**	(3.0)	**(6.8)**	(9.1)	**(6.2)**	(12.1)
Other	**0.3**	(0.4)	**0.1**	–	**(0.1)**	0.2	**–**	0.6	**0.3**	0.4
AFFO	**18.2**	27.1	**22.1**	19.5	**20.4**	11.2	**10.4**	26.8	**71.1**	84.6

(1) "AFFO" is not a recognized measure under GAAP and does not have a standardized meaning prescribed by GAAP. Refer to the discussion of non-GAAP measures.
(2) Represents total facility maintenance capital expenditures less depreciation for furniture, fixtures, equipment and computers (FFEC) already deducted in determining FFO.

Capital Structure

The following table summarizes the continuity of our capital structure for each of 2013 and 2012.

(thousands of dollars unless otherwise noted)	**2013**	2012
Shareholders' Equity		
Common Shares	**476,480**	467,463
Equity portion of convertible debentures	**5,573**	5,573
Contributed surplus	**48**	48
	482,101	473,084
Accumulated deficit at beginning of year	**(395,024)**	(386,174)
Net earnings for the year	**5,252**	62,656
Dividends/distributions declared	**(52,022)**	(71,497)
Other	**–**	(9)
Accumulated deficit at end of year	**(441,794)**	(395,024)
Accumulated other comprehensive loss	**(2,441)**	(23,400)
Shareholders' equity	**37,866**	54,660
U.S./Canadian dollar exchange rate at end of year	**1.0636**	0.9949

Share Information *(thousands)*	**January 31, 2014**	**December 31, 2013**	December 31, 2012
Common Shares (TSX symbol: EXE)[(1)]	**87,346.3**	**87,266.5**	85,989.4

(1) Closing market value per the TSX on January 31, 2014, was $7.14.

The closing rates used to translate assets and liabilities of the U.S. operations were 1.0636 at December 31, 2013, and 0.9949 at December 31, 2012. As a result of the weaker Canadian dollar at December 31, 2013, the assets of Extendicare's U.S. operations increased by approximately $89.1 million, partially offset by an increase in the liabilities of approximately $70.7 million, with the net change in foreign currency translation of $18.4 million included in accumulated other comprehensive loss. Every one-cent increase (decrease) in the Canadian dollar against the U.S. dollar would impact the net assets of our U.S. operations by approximately $2.5 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive loss.

DISTRIBUTIONS

We generated AFFO of $71.1 million in 2013, and declared dividends totalling $52.0 million that were paid out from February 15, 2013 to January 15, 2014. The portion distributed in cash was $43.7 million and $8.3 million was by way of shares issued under a dividend reinvestment plan. A total of 1,277,135 Common Shares were issued in 2013 through the dividend reinvestment plan.

In 2012, we generated AFFO of $84.6 million and declared monthly distributions totalling $71.5 million that were paid out from February 15, 2012 to January 15, 2013. The portion distributed in cash was $57.1 million and $14.4 million was by way of shares/units issued under a distribution reinvestment plan. A total of 1,881,488 Common Shares/REIT Units were issued in 2012 through the distribution reinvestment plan.

There are a number of factors that affect the quarterly funds generated for distribution that our Board takes into consideration in determining the monthly distributions for the year. Factors affecting quarterly trends in earnings are discussed under the headings "Adjusted Funds from Operations", "Summary of Quarterly Results" and "2013 Financial Review".

The declaration and payment of future distributions is at the discretion of our Board as to the amount and timing of dividends to be declared and paid, after consideration of a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of Extendicare, debt covenants and obligations, and any other factors deemed relevant by the Board. If our Board determines that it would be in Extendicare's best interests, it may reduce, for any period, the amount and frequency of dividends to be distributed to holders of Common Shares.

NORMAL COURSE ISSUER BID

On July 5, 2012, Extendicare received the approval of the TSX to commence a normal course issuer bid (the "Bid") to purchase for cancellation up to 4.0 million Common Shares, representing approximately 4.8% of the public float on July 1, 2012. The Bid commenced on July 9, 2012, and provided Extendicare with flexibility to repurchase Common Shares for cancellation until July 8, 2013. The Company did not acquire any shares for cancellation under the Bid during 2013. In July 2012, Extendicare acquired for cancellation 13,600 Common Shares at a cost of $0.1 million (average cost of $7.81 per share).

ACCRUAL FOR SELF-INSURED LIABILITIES

The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. General and professional liability claims are the most volatile and significant of the risks for which Extendicare self-insures. Actual results can differ materially from the estimates made due to a number of factors including the assumptions used by management and other market factors.

As at December 31, 2013, the accrual for self-insured general and professional liabilities increased by $19.4 million to $115.3 million (US$108.4 million) compared to $95.9 million (US$96.4 million) at the beginning of the year. The current period provision, net of claims payments, increased the accrual by $11.8 million, with the balance primarily due to the impact of the weaker Canadian dollar and accretion of the discount.

Payments for self-insured liabilities were $42.7 million in 2013 and $23.9 million in 2012. Provisions for potential general and professional liability claims were $54.5 million (US$52.9 million) in 2013 and $40.8 million (US$40.8 million) in 2012.

The results of our three independent actuarial reviews completed during 2013, necessitated the continued strengthening of our reserves. Our quarterly provisions for 2013 were US$9.4 million, US$9.2 million, US$14.0 million, and US$20.3 million, respectively. Approximately US$22.2 million of the total US$52.9 million recorded in 2013 related to our former Kentucky operations, as we continue to process the settlement of those claims. Of the balance of the provision of US$30.7 million, approximately US$5.7 million related to the strengthening of prior years' reserves in other states, and US$25.0 million related to potential claims for the 2013 period. In 2012, we had indicated that our provision for self-insured liabilities was anticipated to reduce to a level of approximately US$12 million annually following our exit from Kentucky. However, that projected reduction has not occurred due to an increase in claims in other states.

For the year ended December 31, 2012, payments for self-insured liabilities were $23.9 million compared to $35.1 million in 2011. Provisions recorded in 2012 for potential general and professional liability claims were $40.8 million (US$40.8 million), of which $16.6 million (US$16.6 million) related to the strengthening of our prior years' reserves. In comparison, for the 2011 year, our provision for self-insured liabilities was $65.3 million (US$66.0 million), of which $42.8 million (US$43.3 million) related to prior years' reserves. The strengthening of our prior years' reserves was primarily attributable to claims in the State of Kentucky and settlement of certain pre-2012 claims in other states. Excluding prior years' reserve adjustments, our provision for self-insured liabilities was US$24.2 million in 2012 compared to US$22.7 million in 2011. Our claims experience in Kentucky had accounted for more than 50% of our provision for self-insured liabilities in 2011 and 2012.

Management regularly evaluates and periodically engages an independent third-party actuary to provide a report to determine the appropriateness of the carrying value of this liability. In 2011, we commenced the practice of performing an independent actuarial review three times during the calendar year, by adding a review in the second quarter, in addition to the normal third and fourth quarter reviews. Assumptions underlying the determination of the liability are limited by the uncertainty of predicting future events and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; trends in claims along with unique and identifiable settlements; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation. Therefore, management's estimate of the accrual for general and professional liability claims is significantly influenced by assumptions that are subject to judgement by management and the actuary, which may cause the provision to fluctuate significantly from one reporting period to another. Differences between the ultimate claims costs and our historical provisions for loss and actuarial assumptions and estimates could have a material adverse effect on our business, operating results and financial condition.

Most of the risks that Extendicare self-insures are long-term in nature and accordingly, claims payments for any particular policy year occur over a long period of time. However, management estimates and allocates a current portion of the accrual for self-insured liabilities on the statement of financial position. As at December 31, 2013, management estimated that $28.1 million of the accrual for self-insured general and professional liabilities will be paid within the next year. The timing of payments is not directly within management's control and, therefore, estimates could change in the future.

Within our Bermuda-based captive insurance company, we hold investments sufficient to support the accrual for self-insured liabilities and to meet the required statutory solvency and liquidity rations. These invested funds are reported in other assets and totalled $118.8 million (US$111.7 million) at December 31, 2013, compared to $115.0 million (US$115.6 million) at December 31, 2012. Management believes there are sufficient cash resources to meet estimated current claims payment obligations.

LONG-TERM DEBT

Long-term debt, including current portion and net of financing costs, was $1,175.2 million at December 31, 2013, compared with $1,132.2 million at December 31, 2012. The current portion of long-term debt was $158.4 million at December 31, 2013, of which $10.3 million was classified as liabilities of disposal group held for sale in connection with two of the 11 U.S. skilled nursing centers held for sale. The remaining current portion of long-term debt of $148.1 million at the end of 2013 includes the convertible unsecured subordinated debentures due in June 2014 (the "2014 Debentures") with a carrying value of $114.2 million, and a face value of $113.9 million. The current portion of long-term debt of $93.4 million at December 31, 2012, included PrivateBank loans of US$33.9 million and $15.5 million of mortgages that were refinanced during 2013.

Details of the components, terms and conditions of long-term debt are provided in *note 14* of the 2013 consolidated financial statements. Extendicare and its subsidiaries are in compliance with all of their respective financial covenants as at December 31, 2013.

The following summarizes the changes in the carrying amounts of long-term debt for each of 2013 and 2012.

Continuity of Long-term Debt *(millions of dollars)*	**2013**	2012
Long-term debt at beginning of year, prior to financing costs	**1,163.0**	1,156.6
Issue of long-term debt		
Mortgages	**64.3**	164.4
2019 Debentures (net of $5.8 million allocated to equity)	**–**	120.7
Construction loans	**30.3**	37.7
Notes payable/other	**1.1**	1.1
Redemption of 2013 Debentures at face value	**–**	(91.8)
Net repayment on the EHSI Credit Facility	**(6.2)**	(44.9)
Repayment of long-term debt	**(84.1)**	(162.7)
Revaluation of convertible debentures carried at fair value and accretion	**(2.4)**	(4.7)
Change due to period-end foreign exchange rate	**39.0**	(13.4)
	1,205.0	1,163.0
Financing costs at end of year	**(29.8)**	(30.8)
Long-term debt at end of year	**1,175.2**	1,132.2
Less: portion classified as liabilities of disposal group held for sale	**(10.3)**	–
Less: current portion	**(148.1)**	(93.4)
	1,016.8	1,038.8

Interest Rates and Aggregate Debt Maturities

Management has limited the amount of debt that may be subject to changes in interest rates. As a result, all but $2.2 million (US$2.1 million drawn under the EHSI Credit Facility) of our long-term debt outstanding at December 31, 2013, was at fixed rates.

The weighted average interest rate of our long-term debt was approximately 4.9% as at December 31, 2013 (5.4% for our Canadian operations and 4.3% for our U.S. operations), compared to 5.0% at December 31, 2012. The weighted average term to maturity of our long-term debt, including finance lease obligations, was 19.2 years as at December 31, 2013 (8.9 years for our Canadian operations and 30.1 years for our U.S. operations), compared to 18.5 years as at December 31, 2012. Excluding our finance lease obligations, the weighted average term to maturity of our long-term debt was 19.7 years (7.9 years for our Canadian operations and 30.2 years for our U.S. operations).

Our consolidated interest coverage ratio for 2013 was 2.6 times (2012 – 3.0 times). Interest coverage is defined as Adjusted EBITDA divided by net interest, which represents interest expense net of interest revenue. The decline in our interest coverage for 2013 reflects the decline in our Adjusted EBITDA, partially offset by lower net interest costs.

The following table presents principal, or notional, amounts and related weighted average interest rates by year of maturity for the Company's debt obligations as at December 31, 2013. It incorporates only exposures that existed at that date and does not consider exposures, or positions that could arise subsequently, or future interest rate movements. As a result, the information has limited predictive value. The ultimate results with respect to interest rate fluctuations will depend on the exposures that occur, hedging strategies at the time and interest rate movements.

Debt Obligations *(millions of dollars unless otherwise noted)*	2014	2015	2016	2017	2018	After 2018	Total	Fair Value
Canadian Operations								
Convertible debentures (at face value)								
Fixed rate	113.9	–	–	–	–	126.5	240.4	242.0
Average interest rate	5.70%	–	–	–	–	6.00%	5.86%	
Long-term debt								
Fixed rate	20.0	14.0	20.4	31.2	18.0	167.9	271.5	282.3
Average interest rate	4.41%	4.66%	4.67%	4.44%	4.88%	5.14%	4.46%	
Finance lease obligations								
Fixed rate	5.0	5.3	5.7	6.1	6.5	77.1	105.7	118.7
Average interest rate	7.00%	7.00%	7.00%	7.00%	7.00%	6.99%	6.99%	
United States Operations(1)								
Long-term debt								
Fixed rate	10.8	11.1	11.6	12.0	12.5	518.8	576.8	549.1
Fixed rate included in liabilities held for sale	0.2	0.2	0.2	0.2	0.3	9.6	10.7	10.7
Average interest rate	4.34%	4.32%	4.28%	4.28%	4.28%	4.30%	4.30%	
Variable rate	–	2.2	–	–	–	–	2.2	2.2
Average interest rate	–	5.50%	–	–	–	–	5.50%	
Finance lease obligations								
Fixed rate	1.5	0.7	0.1	–	–	–	2.3	2.3
Average interest rate	5.12%	5.05%	1.02%	–	–	–	5.12%	

(1) U.S. dollar denominated debt is translated to Canadian dollars at a rate of 1.0636.

OTHER CONTRACTUAL OBLIGATIONS

The table below provides summary information about the contractual obligations, other than long-term debt, as at December 31, 2013. Due to the uncertainty as to the timing of payments to be made with respect to certain obligations, the table excludes our self-insured liabilities and decommissioning provisions, totalling $115.3 million and $28.8 million, respectively, as at December 31, 2013, and also excludes our defined benefit pension plan obligations, which are described more fully below.

Other Contractual Obligations *(millions of dollars)*	**Total**	To the end of 2014	2015	2016	2017	2018	After 2018
Canadian Subsidiary Operations							
Operating lease obligations	**9.2**	2.3	1.9	1.6	1.4	1.1	0.9
Purchase obligations	**3.3**	3.3	–	–	–	–	–
United States Subsidiary Operations(1)							
Operating lease obligations	**28.7**	6.1	4.9	4.7	4.3	3.6	5.1
Purchase obligations	**9.5**	9.5	–	–	–	–	–
	50.7	21.2	6.8	6.3	5.7	4.7	6.0

(1) Obligations denominated in U.S. dollars are translated to Canadian dollars at a rate of 1.0636.

In addition to the operating lease amounts identified in the table above, EHSI remains party to master leases between Assisted Living Concepts, Inc. (ALC) and LTC Properties, Inc. (LTC) following the reorganization completed in November 2006. For further details on these commitments, refer to "Off-balance Sheet Arrangements".

Defined Benefit Pension Plan Obligations

The contractual obligations table excludes our defined benefit pension plan obligations. The accrued benefit liability on our statement of financial position as at December 31, 2013, was $35.2 million (December 31, 2012 – $35.8 million). We currently have defined benefit registered and supplementary plans covering certain executives, both of which have been closed to new entrants since 2000. The registered defined benefit plan was in an actuarial deficit of $1.6 million with plan assets of $5.7 million and accrued benefit obligations of $7.3 million as at December 31, 2013 (December 31, 2012 – an actuarial deficit of $1.9 million with plan assets of $5.7 million and accrued benefit obligations of $7.6 million). The accrued benefit obligations of the supplementary plan were $33.6 million as at December 31, 2013 (December 31, 2012 – $33.8 million). We do not set aside assets in connection with the supplementary plan and the benefit payments will be paid from cash from operations. The benefit obligations under the supplementary plan are secured by letters of credit totalling $42.0 million as at December 31, 2013 (December 31, 2012 – $42.7 million). The expected annual benefit payments under the supplementary pension plan that will be funded from cash from operations over the next five years range between $2.0 million and $2.2 million, and the annual contributions to the registered pension plan over the next five years are expected to be less than $0.1 million. Since the majority of our accrued benefit obligations represent our obligation under our non-registered supplementary plan, which is not required to be funded, the recent capital market turmoil is not expected to have a material adverse effect on our cash flow requirements with respect to our pension obligations, or our pension expense.

Future Liquidity and Capital Resources

As at December 31, 2013, Extendicare's consolidated cash on hand totalled $96.0 million, excluding restricted cash of $18.7 million. The balance of cash on hand held by EHSI was US$37.5 million, and EHSI had US$76.0 million available under the EHSI Credit Facility, subject to leverage requirements. Our Canadian operations had cash on hand of $55.7 million and had $21.7 million available under the RBC Credit Facility. In addition, as at December 31, 2013, we had 57 unencumbered nursing centers in the U.S. with an estimated value of between US$250 million and US$300 million, which includes 19 centers that are leased to a third-party operator in Kentucky.

We are currently projected to spend in the range of $38 million to $43 million in facility maintenance capital expenditures and $15 million to $20 million in growth capital expenditures in 2014. As at December 31, 2013, EHSI and ECI had outstanding capital expenditure commitments totalling US$9.0 million and $3.3 million, respectively. EHSI's commitments include a purchase obligation of US$6.0 million to acquire a skilled nursing center (108 beds) that it currently leases in Ohio. ECI's commitments relate to the Timmins construction project.

The 2014 Debentures mature on June 30, 2014, and require Extendicare to either repay them in full or refinance them through the capital markets. Management continues to closely monitor the financial markets and believes that the Company has the full financial capacity and ability to execute a plan to complete the refinancing of the 2014 Debentures. Although management has the confidence to complete the refinancing, there can be no assurance given that the Company will succeed in the refinancing of the 2014 Debentures prior to their maturity.

Management remains confident that cash from operating activities, together with available bank credit facilities, will be sufficient to meet Extendicare's current requirements to support ongoing operations, facility maintenance capital expenditures, and debt repayment obligations. Extendicare's approach to distributing funds available from operations, necessitates raising funds through debt financings and the capital markets to fund strategic acquisitions and growth capital expenditures.

RELATED PARTY TRANSACTIONS

Tim Lukenda, Extendicare's President and Chief Executive Officer, is the former President of Tendercare (Michigan) Inc. (Tendercare), a company acquired by EHSI in 2007, in which Mr. Lukenda owned an approximate 4.6% direct and indirect interest. Mr. Lukenda's employment contract provides a mechanism and process that effectively removes him from the decision-making process in situations where a conflict of interest may arise on any matter between the Company and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with the Company.

In connection with the purchase of Tendercare, the acquired working capital was subject to annual adjustments over a four-year period. The final working capital adjustment was paid in the third quarter of 2012, bringing the total of the payments to US$5.5 million by EHSI.

In 2008, ECI acquired LTC Professional Insurance Company, Ltd. (LTC Professional), Tendercare's affiliated insurance company, for a nominal amount. Consideration for the acquisition was adjusted for annually based upon the actuarial liabilities determined at the end of each year through to 2012. The final adjusting payment was made in March 2013, in the amount of US$0.5 million, bringing the total of the adjustments made to US$5.6 million.

In July 2013, ECI sold one of its closed nursing centers for $1.2 million to a company owned by members of Mr. Lukenda's family, of which Mr. Lukenda owns an approximate 7.1% direct and indirect interest.

In addition, with respect to other long-term care centers that are partly owned by Mr. Lukenda and his immediate family, ECI provides certain management services to a long-term care center in Ontario, Canada, and prior to April 2013, ECI operated under lease arrangements, a second long-term care center in Ontario. In addition, EHSI operates under lease arrangements, a skilled nursing center in Michigan, and until August 2013, EHSI provided certain management services to an assisted living center in Michigan.

OFF-BALANCE SHEET ARRANGEMENTS

Both ALC and EHSI are the lessees under lease agreements with LTC (the "LTC Master Leases"), which cover 37 assisted living properties operated solely by ALC that are not part of EHSI's operations. LTC declined to remove EHSI as a party to the leases at the time of the distribution of ALC by Extendicare to its shareholders in 2006 and, accordingly, EHSI continues to be directly liable to LTC for rent payments and other obligations owing under the LTC Master Leases, notwithstanding that EHSI does not have any financial interest in the operations of the 37 centers. A separation agreement entered into between Extendicare and ALC (the "Separation Agreement"), provides that ALC will indemnify EHSI against any expenses, liabilities and costs incurred by EHSI, including rent payments relating to the LTC Master Leases. The aggregate minimum rental payments for the 2013 calendar year were approximately US$11.8 million and will increase by 2% for the 2014 calendar year. The leases expire in December 2014, and in January 2014, LTC announced that it does not intend to renew the leases with ALC.

In July 2013, all of the outstanding shares of ALC were acquired by an affiliate of TPG Capital, L.P. (TPG), a global private investment firm, for cash. Management does not believe that this transaction will have an impact on either EHSI being a co-tenant under the LTC Master Leases, nor the indemnification between Extendicare and ALC provided within the Separation Agreement.

Extendicare has not recorded any potential liability for this exposure.

RISKS AND UNCERTAINTIES

General Business Risks

Extendicare is subject to general business risks inherent in the long-term care industry, including: increased government regulation and oversight; changing consumer preferences; fluctuations in occupancy levels; the inability to achieve adequate government funding increases; increases in labour costs and other operating costs; possible future changes in labour relations; competition from or the oversupply of other similar properties; changes in neighbourhood or location conditions and general economic conditions; health related risks; disease outbreaks and control risks; changes in accounting principles and policies; the imposition of increased taxes or new taxes; capital expenditure requirements; changes in interest rates; and changes in the availability and cost of long-term financing, which may render refinancing of long-term debt difficult or unattractive. Any one of, or a combination of, these factors may adversely affect the business, results of operations and financial condition of the Company.

Risks Related to Government Funding and Regulatory Changes

Extendicare's earnings are highly reliant on government funding and reimbursement programs, both in the U.S. and in Canada, and the effective management of staffing and other costs of operations, which are strictly monitored by government regulatory authorities. Given that we operate in a labour-intensive industry, where labour-related costs account for a significant portion of our operating costs (approximately 73% in 2013), government funding constraints could have a significant adverse effect on our results from operations and cash flows. Management is unable to predict whether governments will adopt changes in their funding and reimbursement programs, and if adopted and implemented, what effect such changes will have on the Company.

Further information on funding and legislative changes affecting the industry can be found under "Update of Regulatory and Reimbursement Changes Affecting Revenue".

All long-term care providers are subject to surveys, inspections, audits and investigations by government authorities to ensure compliance with applicable laws and licensure requirements of the federal, state and/or provincial funding programs. Nursing centers must comply with applicable regulations that, depending on the jurisdiction in which they operate, may relate to such things as staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental and other standards. The government review process is intended to determine compliance with survey and certification requirements, and other applicable laws. Remedies for survey deficiencies can be levied based upon the scope and severity of the cited deficiencies. Remedies range from the assessment of fines to the withdrawal of payments under the government funding programs. Should a deficiency not be addressed through a plan of correction, a center can be decertified from the funding program. As at December 31, 2013, we had certain centers under plans of correction at EHSI, but no centers had been decertified. While it is not possible to estimate the final outcome of the required corrective actions, the Company has accrued for known remedial costs.

Government agencies have steadily increased their enforcement activity over the past several years. As a result, in addition to increasing resources to improve the quality of services provided to our residents, we are continually allocating increased resources to ensure compliance with applicable laws and regulations and to respond to inspections, investigations and/or enforcement actions. Our costs to respond to and/or defend surveys, inspections, audits and investigations are significant and are likely to increase in the current environment.

Non-compliance with applicable laws and licensure requirements governing long-term care could result in adverse consequences, including severe penalties, which may include criminal sanctions and fines, civil monetary penalties and fines, administrative and other sanctions, including exclusion from participation in the Medicare and Medicaid programs, or one or more third-party payor networks. We may be required to refund amounts that have been paid to us by federal, state and/or provincial funding programs. These penalties could have a material adverse effect on the business, results of operations or financial condition of the Company.

UNITED STATES

EHSI receives payment for its services and products from the federal (Medicare) and state (Medicaid) medical assistance programs, Managed Care organizations (including HMO and preferred provider organizations), commercial insurers, the Department of Veterans Affairs, as well as from private payors.

Limitations on U.S. Medicare and Medicaid reimbursement for health care services are continually proposed. Medicare and Medicaid reimbursement programs are complicated and constantly changing as CMS and the various states continue to refine their programs. There are considerable administrative costs incurred by EHSI in monitoring the changes made within the programs, determining the appropriate actions to be taken to respond to those changes and implementing the required actions to meet the new requirements and minimize the repercussions of the changes to EHSI's reimbursement rates and costs. There can be no assurance that Medicare and Medicaid reimbursement programs will remain at levels comparable to present levels or that they will, in the future, be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to such programs. Therefore, government funding constraints could have a significant adverse effect on the Company's results from operations and cash flows. Further information on funding and legislation changes affecting our industry in the United States can be found under "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

EHSI participates in federal and state health care programs and, therefore, is subject to a variety of federal and state laws that are intended to prevent health care fraud and abuse. Violation of these laws is punishable by criminal, civil and administrative penalties, including, in some instances, exclusion from participation in federal and state health care programs. These laws include, but are not limited to, anti-kickback laws, false claims laws, physician self-referral laws and federal criminal health care fraud laws. EHSI cannot reasonably predict whether enforcement activities will increase at the federal or state level or the effect of such enforcement activities on its business and its financial results.

U.S. federal law requires each state to have a Medicaid Fraud Control Unit, which is responsible for investigating provider fraud and resident abuse in Medicaid-funded centers. EHSI has been investigated by these Medicaid Fraud Units previously, but it is not aware of any liability relating thereto at this time. Management believes that EHSI and its subsidiaries have been and continue to be in material compliance with all of these laws as they apply to its companies.

EHSI believes its billing practices, operations and compensation and financial arrangements with referral sources and others materially comply with applicable federal and state requirements. However, EHSI cannot give assurance that a governmental authority will not interpret such requirements in a manner inconsistent with EHSI's interpretation and application.

CANADA

In Canada, provincial legislation and regulations closely control all aspects of the operation and funding of nursing centers, including the fee structure, subsidies, the adequacy of physical centers, standards of care and accommodation, equipment and personnel. There can be no assurance that the current level of fees and subsidies will continue or that such fees will increase commensurate with ECI's costs of care. A reduction of such fees or subsidies could have an adverse effect on the business, results of operations and financial condition of the Company. Further information on funding and legislation changes affecting our industry in Canada can be found under "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada".

The revocation of a license by authorities or cancellation of a service contract due to inadequate performance by the operator has been historically infrequent in Canada and is usually preceded by a series of warnings, notices and other sanctions. ECI has never had such a license or service contract revoked. While ECI endeavours to comply with all regulatory requirements in its Canadian nursing centers, it is not unusual for stringent inspection procedures to identify deficiencies in operations. Every effort is made to avoid and mitigate notices of deficiencies through quality assurance strategies. As well, all efforts are undertaken to correct all legitimate problem areas that have been identified through regulatory inspections.

In Ontario, licenses for nursing centers are issued for a fixed term not to exceed 25 years, depending on the bed classification in accordance with the LTC Act 2007. Long-term care operations will be given notification of whether or not a new license will be issued at least three years before the end of the license term.

In Ontario, the MOHLTC initiated plans in 2007 to redevelop 35,000 older long-term care beds over 15 years. The first phase of the renewal strategy was launched in 2009, with eligible participants receiving a construction funding subsidy over 25 years. ECI owns 21 nursing centers with 3,287 class "C" beds in Ontario that are at risk of losing their licenses in June 2025 should they not be redeveloped to meet the new standards. In response to concerns raised by the industry regarding the design standards and the adequacy of the construction funding subsidy, the MOHLTC commenced a review of the program in 2011, and we are awaiting a report on its recommendations and or proposed changes to the program (see "Ontario Redevelopment Program" under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada").

Risks Related to Litigation

LIABILITY AND INSURANCE

Operators within the long-term care industry, including the Company, face lawsuits alleging negligence, malpractice, or other related claims and, as a result, incur significant costs in connection with defending general and professional liability claims, workers' compensation claims, and property based claims. In addition to large compensatory claims, plaintiffs' attorneys also seek significant punitive damages and attorneys' fees. The Company maintains insurance coverage for the significant majority of risk associated with claims in respect to general and professional liability, directors' and officers' liability, employers' liability, auto liability, health and dental benefits, business income and property. General and professional liability policies currently offered in the long-term care industry are generally only offered on a "claims made" basis, as opposed to "occurrence based" coverage. "Claims made" policies are subject to possible rate increases upon renewal due to a step-up factor used by the insurer.

The Company maintains general and professional liability and property insurance policies through third-party insurers, along with retaining a portion of risk within its Bermuda-based captive insurance structure, in amounts and with the coverage and deductibles it believes are adequate based on the nature and risks of its business, historical experience and industry standards, as well as the type of insurance coverage commercially available in the marketplace. Provisions for loss for our professional liability risks are based upon management's best available information including actuarial estimates. The Bermuda-based captive insurance company of Extendicare is currently appropriately capitalized, but there can be no assurance that it will remain appropriately capitalized in the future should claims against the Company increase significantly.

From time to time, EHSI has elected to self-insure the risk associated with workers' compensation claims up to a certain per claim limit and aggregate exposure limit, along with the arrangement of third-party insured products. In addition, EHSI self-insures its health and dental coverage. The Company's costs are subject to changes caused by the number and nature of claims incurred. The Company employs risk management personnel to assist its centers in the appropriate measures to maintain a safe workplace environment and to manage workers' compensation claims. If the Company is not able to control these costs, this could adversely affect the business, results of operations and financial condition of the Company.

A successful claim against the Company not covered by, or in excess of, such insurance, or in excess of the Company's reserves for self-insured retention levels, could have a material adverse effect on the business, operating results and financial condition of the Company. In many states, state law prohibits or limits insurance coverage for the risk of punitive damages arising from general and professional liability claims and/or litigation. Furthermore, there are certain types of risks, generally of a catastrophic nature, such as war, non-certified acts of terrorism, or environmental contamination, which are either uninsurable or are not insurable on an economically viable basis. Under these circumstances, the Company may be liable for such losses. Also, in order to obtain liability insurance at a more reasonable cost or in some instances to obtain coverage at all, the Company is required to assume self-insurance retention levels for its general and professional liability claims. The Company estimates the value of losses that may occur within its self-insured retention levels based on historical claims, actuarial valuations, third-party administrator estimates, industry data and advice from consultants and legal counsel and endeavours to reserve for such liabilities. If the estimates of the Company are inaccurate or if there are an unexpectedly large number of successful claims that result in liabilities in excess of the reserves of the Company for losses, the operating results of the Company could be negatively affected. Claims against the Company, regardless of their merit or eventual outcome, also may have a material adverse effect on the ability of the Company to attract residents and patients, expand the business of the Company or maintain favourable standings with regulatory authorities. These claims also require management to devote time to matters unrelated to the operation of the business.

The Company has to renew its insurance policies each year or on a periodic basis and negotiate acceptable terms for coverage, exposing it to the volatility of the insurance markets, including the possibility of rate increases resulting from the claims experience of the Company or the aggregate claims experience of the long-term care industry. There can be no assurance that the Company will be able to obtain insurance in the future or, if available, that such coverage will be available on acceptable terms and provide coverage for perils inherent to the senior care industry.

COMPLIANCE WITH REGULATORY REQUIREMENTS

EHSI is subject to review or audit by federal and state governmental agencies to verify compliance with the requirements of the Medicare and Medicaid programs. Audits under the Medicare and Medicaid programs have intensified in recent years. Private payors may also have the right to review or audit our files. These activities could result in an obligation to repay amounts received pursuant to these programs. The payment of penalties, exclusion from participation in one or more government programs or a loss of a contract with a private payor could materially adversely affect the business results of operations and financial condition of the Company.

EHSI is also subject to lawsuits under the Federal False Claims act and comparable state laws. These lawsuits, which may be initiated by whistleblowers, can involve significant monetary damages, attorneys' fees and the award of bounties to private plaintiffs who successfully bring these suits and to the government programs. See "Overview – Significant 2013 Events and Developments – Legal Proceedings and Regulatory Actions".

In the United States and Canada, there are a number of federal, state and provincial laws protecting the confidentiality of certain patient health information, including patient records, and restricting the use and disclosure of that protected information. In particular, the privacy rules under the *Health Insurance Portability and Accountability Act of 1996* (HIPAA) in the U.S. and under the *Personal Information Protection and Electronic Documents Act* (PIPEDA) in Canada protect medical records and other personal health information by limiting their use and disclosure of health information to the minimum amount reasonably necessary to accomplish the intended purpose. If the Company was found to be in violation of the privacy or security rules under HIPAA, PIPEDA or other laws protecting the confidentiality of patient health information, it could be subject to sanctions and civil or criminal penalties, which could increase its liabilities, harm its reputation and have a material adverse effect on the business, results of operations and financial condition of the Company.

INDEMNIFICATION OBLIGATIONS BETWEEN ALC AND EXTENDICARE

In connection with the distribution by Extendicare of shares of ALC to shareholders of Extendicare in 2006, Extendicare, EHSI and ALC entered into a number of transactions and agreements, including the Separation Agreement and a number of agreements relating to the transfer of assisted living centers from EHSI to ALC. Pursuant to the Separation Agreement, ALC has agreed to indemnify, defend and hold harmless Extendicare and certain of its related parties for identifiable losses relating to or arising from certain specified matters, including matters relating to or arising from ALC's assisted living care business and Extendicare has agreed to indemnify, defend and hold harmless ALC and certain related parties from certain other specified matters, including matters relating to those assets and liabilities that were not transferred to ALC as part of the separation.

As described under the heading "Off-balance Sheet Arrangements", EHSI is bound by the terms of the LTC Master Leases that cover 37 assisted living properties operated by ALC. The Separation Agreement provides that ALC will indemnify EHSI against any expenses, liabilities and costs incurred by EHSI, including rent payments relating to the LTC Master Leases. The aggregate minimum rental payments for the 2013 calendar year were approximately US$11.8 million and will increase by 2% for the 2014 calendar year. The leases expire in December 2014, and in January 2014, LTC announced that it does not intend to renew the leases with ALC.

Risks Related to Tax Rules and Regulations

Extendicare is subject to audits from federal, state and provincial tax jurisdictions and, therefore, is subject to risk in the interpretation of tax legislation and regulations. Tax regulations are complex and require careful review by the Company's tax management and its external tax consultants. Differences in interpretation of those tax rules and regulations could result in tax assessments and penalties for the untimely payment of the determined tax liability, which could have a material adverse effect on the business, results of operations and financial condition of the Company.

ALC SPIN-OFF

The Extendicare reorganization completed in November 2006 (the "2006 Arrangement") included the distribution by Extendicare of shares of ALC to the shareholders of Extendicare and a number of pre-2006 Arrangement transactions. In connection with the 2006 Arrangement, EHSI received a note upon the transfer of ALC to its Canadian affiliate, which note was subsequently repaid by way of cash, settlement against other notes and dividends of US$476.6 million. Based upon internal calculations, management believes there was sufficient surplus and basis as to not attract any Canadian taxes from the transactions relating to the repayment of the note. Extendicare and its Canadian affiliates are currently under audit by the Canada Revenue Agency (CRA). Should the CRA determine that the available surplus was less than the amount determined by management, Canadian capital gains tax would apply to the shortfall.

Risks Related to Financing

DEBT FINANCING

Due to the level of real property ownership by the Company, a significant portion of the consolidated cash flow of the Company is devoted to servicing debt, and there can be no assurance that the Company will continue to generate sufficient cash flow from operations to meet required interest and principal payments. If the Company were unable to meet interest or principal payments, it could be required to seek renegotiation of such payments or obtain additional equity, debt or other financing.

The 2014 Debentures mature on June 30, 2014, and require Extendicare to either repay them in full or refinance them through the capital markets. Management continues to closely monitor the financial markets and believes that the Company has the full financial capacity and ability to execute a plan to complete the refinancing of the 2014 Debentures. Although management has the confidence to complete the refinancing, there can be no assurance given that the Company will succeed in the refinancing of the 2014 Debentures prior to their maturity.

Extendicare's RBC Credit Facility is a demand facility that is secured by 13 class "C" graded nursing centers in Ontario and is guaranteed by certain Canadian subsidiaries of the Company. The RBC Credit Facility consists of a $64.0 million working capital line that is primarily used to back letters of credit that renew annually. The availability under the working capital line was $21.7 million at December 31, 2013, with letters of credit issued totalling $42.3 million.

Global financial markets and economic events over the past few years have resulted in heightened scrutiny of banking institutions in the lending of credit, and the financial markets continue to be affected by the state of the economy in North America. The Company cannot predict whether future financing will be available, what the terms of such future financing will be (including, whether it will result in a higher cost of borrowing) or whether its existing debt agreements will allow for the timely arrangement and implementation of such future financing. If the Company is unable to obtain additional financing or refinancing when needed or on satisfactory terms, it could have a material adverse effect on the business, operating results and financial condition of the Company.

DEBT COVENANTS

The Company is in compliance with all of its financial covenants as at December 31, 2013. However, there can be no assurance that future covenant requirements will be met. The Company's bank lines and other debt may be affected by its ability to remain in compliance. If the Company does not remain in compliance with its financial covenants, its ability to amend the covenants or refinance its debt may be affected.

CREDIT AND INTEREST RATES

The Company has limited the amount of debt that may be subject to changes in interest rates. As a result, all but $2.2 million of the Company's total long-term debt outstanding at December 31, 2013, was at fixed rates. The Company primarily finances its senior care centers through fixed-rate mortgages and considers securing interest rate swap agreements for any variable-rate debt. The Company maintains risk management control systems to monitor interest rate risk attributable to its outstanding or forecasted debt obligations as well as any offsetting hedge positions. The Company does not enter into financial instruments for trading or speculative purposes.

Risks Related to Foreign Currency Rate Fluctuations

The majority of the Company's operations are conducted in the United States and the financial position and results of the U.S. operations are denominated in U.S. dollars. The U.S. operations accounted for 62.8% of our consolidated revenue from continuing operations and 47.5% of our AFFO in 2013. The revenues and expenses of the self-sustaining U.S. operations are translated at average rates of exchange in effect during the period. Assets and liabilities are translated at the exchange rates in effect at the balance sheet date. As a result, the Company's consolidated financial position is subject to foreign currency fluctuation risk, which could adversely impact its operating results and its cash flows.

As well, the Company's dividends are denominated in Canadian dollars from the operating cash flow generated by both its Canadian and U.S. operations. As a result, the cash available for distribution could be adversely impacted by foreign currency fluctuations. Management has a foreign currency hedging strategy whereby it monitors and considers entering into FCFCs to reduce the risks associated with changes in the U.S. dollar and the impact such changes could have on the Company's Canadian dollar distributions. The Company has not had any FCFCs in place since June 2011. Management continues to monitor the exchange rates and to consider future FCFCs to the extent that they may be beneficial to the Company. There can be no assurance that future FCFCs, if any, will be sufficient to protect the Company against currency exchange rate losses.

Risks of Property Ownership

REAL PROPERTY OWNERSHIP

All real property investments are subject to a degree of risk. They are affected by various factors, including changes in general economic conditions (such as the availability of long-term mortgage funds) and in local conditions (such as an oversupply of space or a reduction in demand for real estate in the area), the attractiveness of the properties to patients and residents, competition from other available space and various other factors. In addition, fluctuations in interest rates could have a material adverse effect on the business, operating results and financial condition of the Company.

Extendicare owns, or operates under finance lease arrangements with options to purchase, approximately 99% of its senior care centers, excluding those it operates under management contracts and the 21 Kentucky centers that have been leased to third-party operators. Senior care centers are limited in terms of alternative uses and, therefore, their values are directly driven by the cash flow from operations. The value of real property depends, in part, on government funding and reimbursement programs. The Company's income and funds available for distribution would be adversely affected if federal, state or provincial governments reduced their funding or reimbursement programs, or if a significant number of patients and residents of the senior care centers were to become unable to meet their financial obligations or experienced significant economic setbacks. In addition, overbuilding in any of the market areas of the Company could cause its properties and centers to experience decreased occupancy or depressed margins, which could adversely affect the business, operating results and financial condition of the Company. Moreover, certain significant expenditures involved in real property investments, such as real estate taxes, maintenance costs and mortgage payments, represent liabilities that must be met regardless of whether the property is producing any income.

Real property investments are relatively illiquid, thereby limiting the ability of the Company to vary its portfolio promptly in response to changed economic or investment conditions. There is a risk that the Company would not be able to sell its assets or that it may realize sale proceeds of less than the current book value of its properties.

CAPITAL INTENSIVE INDUSTRY

The Company must commit a substantial portion of its funds to maintain and enhance its senior care centers and equipment to meet regulatory standards, operate efficiently and remain competitive in its markets. Certain of its competitors may operate centers that are more attractive to potential patients and residents due to their age or physical condition. In Ontario, ECI owns 21 nursing centers with 3,287 class "C" beds that would require redevelopment to meet the new standards initiated by the MOHLTC to redevelop 35,000 older long-term care beds in the province over 15 years. However, this program is currently under review by the MOHLTC due to concerns raised by ECI and other operators over the design standards and the adequacy of the construction funding subsidy (see "Ontario Redevelopment Program" under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada"). These as well as other future capital requirements could have a material adverse effect on the business, operating results and financial condition of the Company.

Risks Related to Growth Activities

CONTINUED GROWTH

The Company expects that it will have opportunities to acquire properties or expand existing centers that may be accretive, but there can be no assurance that this will be the case. The ability of the Company to fund growth will be dependent, in part, on external sources of funding. Lack of availability of such funding could limit the future growth of the Company.

State and provincial efforts to regulate the construction or expansion of health care providers could impair the ability of the Company to expand through construction and redevelopment. Most of the states in which EHSI currently operates have adopted laws to regulate the expansion of nursing centers. Certificate of Need (CON) laws generally require that a state agency approve certain acquisitions or physical plant changes and determine that a need exists prior to the addition of beds or services. Some states also prohibit, restrict or delay the issuance of a CON, making it difficult to grow our operations other than by acquisition of existing operations and licensure rights from other providers. Many states have established similar CON processes to regulate the expansion of assisted living centers, but the restrictions are less than those for nursing centers. Similarly in Canada, the provinces restrict the number of licensed nursing center beds and any new licenses are awarded through an RFP process.

If a CON or other similar approvals are required in order to expand operations of the Company, the failure of the Company or inability to obtain the necessary approvals, changes in standards applicable to such approvals and possible delays and expenses associated with obtaining such approvals could adversely affect the ability of the Company to expand and, accordingly, to increase its revenue and earnings.

ACQUISITIONS

The success of the acquisition activities of the Company will be determined by numerous factors, including the ability of the Company to identify suitable acquisition targets, competition for acquisition opportunities, purchase price, ability to obtain adequate financing on reasonable terms, financial performance of the centers after acquisition, and the ability of the Company to effectively integrate and operate the acquired centers. Acquired properties may not meet financial or operational expectations due to unexpected costs associated with acquiring the property, as well as the general investment risks inherent in any real estate investment or acquisition. Moreover, newly acquired long-term care centers may require significant management attention or capital expenditures that would otherwise be allocated to existing centers. Any failure by the Company to identify suitable candidates for acquisition or operate the acquired centers effectively may have an adverse effect on the business, results of operations and financial condition of the Company.

ACCOUNTING POLICIES AND ESTIMATES

Non-GAAP Measures

Extendicare assesses and measures operating results and financial position based on performance measures referred to as "net operating income", "EBITDA", "Adjusted EBITDA", "earnings before depreciation, amortization, loss from asset impairment, disposal and other items", "earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units", "Funds from Operations", and "Adjusted Funds from Operations". These measures are commonly used by Extendicare and its investors as a means of assessing the performance of the core operations in comparison to prior periods. They are presented by Extendicare on a consistent basis from period to period, thereby allowing for consistent comparability of its operating performance. These are not measures recognized under GAAP and do not have standardized meanings prescribed by GAAP. These non-GAAP measures are presented in this document because either: (i) management believes that they are a relevant measure of the ability of Extendicare to make cash distributions; or (ii) certain ongoing rights and obligations of Extendicare may be calculated using these measures. Such non-GAAP measures may differ from similar computations as reported by other issuers and, accordingly, may not be comparable to similarly titled measures as reported by such issuers. They are not intended to replace earnings (loss) from continuing operations, net earnings (loss), cash flow, or other measures of financial performance and liquidity reported in accordance with GAAP.

References to "net operating income" in this document are to revenue less operating expenses. References to "EBITDA" in this document are to earnings (loss) from continuing operations before net finance costs, income taxes, depreciation and amortization. References to "Adjusted EBITDA" in this document are to EBITDA adjusted to exclude the line item "loss (gain) from asset impairment, disposals and other items". As well, "Adjusted EBITDA" is equivalent to the additional GAAP measure presented in our Statements of Earnings referred to as "earnings before depreciation, amortization, loss from asset impairment, disposal and other items". Management believes that certain lenders, investors and analysts use EBITDA and Adjusted EBITDA to measure a company's ability to service debt and meet other payment obligations, and as a common valuation measurement in the long-term care industry. For example, certain of EHSI's debt covenants use Adjusted EBITDA in their calculations.

References to "earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units" in this document are to earnings (loss) from continuing operations excluding the following separately reported line items: "distributions on Exchangeable LP Units", "fair value adjustments", "loss (gain) on foreign exchange and financial instruments", and "loss (gain) from asset impairment, disposals and other items". These line items are reported separately and excluded from certain performance measures, because they are transitional in nature and would otherwise distort historical trends. They relate to the change in the fair value of, or gains and losses on termination of, convertible debentures, Exchangeable LP Units, interest rate agreements and FCFCs, as well as gains or losses on the disposal or impairment of assets, and foreign exchange gains or losses on capital items. In addition, these line items may include provisions for restructuring charges and the write off of unamortized financing costs on early retirement of debt. The above separately reported line items are reported on a pre-tax and on an after-tax basis as a means of deriving earnings from operations and related earnings per share/unit excluding such items.

"Funds from Operations", or "FFO", is defined as Adjusted EBITDA less depreciation for furniture, fixtures, equipment and computers, accretion costs, net interest expense, and current income taxes.

"Adjusted Funds from Operations", or "AFFO", is defined as FFO plus the non-cash portion of financing and accretion costs and the principal portion of government capital funding payments, less the facility maintenance (non-growth) capital expenditures not already reflected in the calculation of FFO.

Both FFO and AFFO are subject to other adjustments, as determined by management in its discretion, that are not representative of Extendicare's operating performance.

Critical Accounting Policies and Estimates

A full discussion of Extendicare's critical accounting policies and estimates is provided in the accompanying notes to the audited consolidated financial statements for the year ended December 31, 2013, and under the heading "Future Change in Accounting Policies" that follows this section.

Management considers an understanding of Extendicare's accounting policies to be essential to an understanding of Extendicare's financial statements because their application requires significant judgement and reliance on estimations of matters that are inherently uncertain. There is measurement uncertainty relating to the accounting policies applied to: revenue recognition and the valuation of accounts receivable; the determination of the recoverable amount of cash generating units (CGU) subject to an impairment test; the valuation of decommissioning provisions; the valuation of self-insured liabilities; the assessment of contingencies; the valuation of financial assets and liabilities; the valuation of share appreciation rights liabilities; and the accounting for tax uncertainties and the tax rates used for valuation of deferred tax assets. The recorded amounts for such items are based on management's best available information and are subject to assumptions and judgement, which may change as time progresses; accordingly, actual results could differ from those estimated.

REVENUE RECOGNITION AND ACCOUNTS RECEIVABLE

In the United States, revenue from skilled nursing centers is derived from various federal and state medical assistance programs, Managed Care providers (for residents with health maintenance and commercial insurance programs), as well as privately from the residents. EHSI derived approximately 77% of its revenue from services provided under various federal or state medical assistance programs during 2013 (2012 – 79%). EHSI records its skilled nursing center revenue in the period in which the services and products are provided at established rates less contractual adjustments. Contractual adjustments include differences between established billing rates and amounts estimated by management as reimbursable under various reimbursement formulas or contracts in effect. Differences between final settlements and amounts recorded in previous periods are reported as adjustments to revenue in the period such settlements are determined. Due to the complexity of laws and regulations governing the federal and state reimbursement programs, there is the possibility that recorded estimates may change by a material amount.

Extendicare also offers information technology services to smaller long-term care providers through its wholly owned U.S. subsidiary, Virtual Care Provider, Inc. This revenue source is primarily derived from application hosting, customer support, telecommunications, equipment sales and consulting services, and is recognized as these services are provided and equipment is delivered to our customers.

In addition, EHSI derives outpatient therapy revenue in the U.S. by providing rehabilitation therapy services to outside third parties at its clinics. This revenue source is primarily from Managed Care, workers' compensation, self-pay clients and partly from Medicare and Medicaid. Revenue is recognized in the period in which services are provided.

In Canada, the fees charged by ECI for its nursing centers and home health care services are regulated by provincial authorities (rather than federal authorities), and provincial programs fund a substantial portion of these fees, with the balance paid for by the residents or customers. Each province has a different system for managing the services provided. As a result, there can be significant variability from location to location with respect to the regulations for providing care and how centers are reimbursed. In 2013, revenue from provincial programs represented approximately 68% of ECI's nursing center operations, and approximately 98% of its home health care services.

Accounts receivable are recorded at amounts expected from federal, state and provincial reimbursement programs, other third-party payors or from individual residents. Receivables from government agencies represent the only concentrated group of accounts receivable for the Company. As at December 31, 2013, receivables from government agencies represented approximately 71% of the total receivables. Management does not believe that there is any significant credit risk associated with these government agencies other than possible funding delays. Receivables from non-government agencies consist of receivables from Managed Care providers, commercial insurers and private individuals that are subject to differing economic conditions, none of which represents any concentrated credit risk to the Company, as there is no significant exposure to any single party. Management estimates which receivables may be collected within one year and reflects those not expected to be collected within one year as non-current assets. Management periodically evaluates the adequacy of its provision for receivable impairment by conducting a specific account review of amounts in excess of predefined target amounts and aging thresholds, which vary by payor type. Allowances for uncollectibility are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, management has established percentages for provision for receivable impairment that are based upon historical collection trends for each payor type and age of these receivables. Accounts receivable that are specifically estimated to be uncollectible, based upon the above process, are fully reserved for in the provision for receivable impairment until they are written off or collected. If circumstances change, for instance due to an economic downturn, resulting in higher than expected defaults or denials, management's estimates of the recoverability of receivables could be reduced by a material amount.

Due to differences in the government funding structures for the services provided, the Canadian operations are not subject to the same risks associated with the collection of accounts receivable as are the U.S. operations. As a result, approximately 95% of the Company's allowance for current accounts receivable at December 31, 2013, was associated with the U.S. operations. The allowance for doubtful accounts for current accounts receivable totalled $21.1 million and $18.5 million at December 31, 2013 and 2012, respectively. Days of revenue outstanding were 38 days at December 31, 2013 compared to 39 days as at December 31, 2012.

At December 31, 2013, EHSI had $13.3 million (US$12.5 million) in Medicare and Medicaid settlement receivables, compared to $23.7 million (US$23.8 million) at the end of 2012. There was no allowance on these receivable balances. It is expected that $3.4 million (US$3.2 million) will be substantially collected within one year and is included in accounts receivable as a current asset, compared to $12.3 million (US$12.3 million) at December 31, 2012. The remaining balance has been classified as a long-term receivable in other assets. Medicare settlement receivables are recoveries of Medicare participants' non-payment of Part A co-insurance receivables. Medicaid settlement receivables pertain to cost-based reimbursement programs. Differences between the final settlement and amounts previously recorded are reported as adjustments to revenue in the period of determination.

VALUATION OF CASH GENERATING UNITS AND IMPAIRMENT

Non-financial assets consist of property and equipment, intangible assets with finite lives, intangible assets with indefinite lives and goodwill. A CGU is defined to be the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets. The Company has identified each individual center as a CGU.

The carrying amounts of non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated annually at the same time or more frequently if warranted. An impairment loss is recognized in net earnings if the carrying amount of an asset or its related CGU, or group of assets on the same basis as evaluated by management, exceeds its estimated recoverable amount.

The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. Goodwill and indefinite life intangible assets are allocated to their respective CGUs for the purpose of impairment testing. Indefinite life intangible assets and corporate assets that do not generate separate cash flows and are utilized by more than one CGU, are allocated to each CGU for the purpose of impairment testing and are not tested for impairment separately.

Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the assets in the CGU on a pro rata basis. Impairment losses on goodwill cannot be reversed. In respect of other non-financial assets, impairment losses recognized in prior periods are assessed at each reporting date for any indication that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

In 2012, we performed the assessment of goodwill of our U.S. operations that resulted in a net pre-tax impairment loss of $0.2 million (US$0.2 million), consisting of a goodwill impairment of $1.1 million (US$1.1 million), a $15.2 million (US$15.5 million) impairment on certain properties and a $16.1 million (US$16.4 million) reversal of a previously recorded impairment loss on property and equipment.

In 2013, our assessment of goodwill for our U.S. operations resulted in a net pre-tax recovery of $0.1 million (US$0.1 million), consisting of a goodwill impairment of $3.7 million (US$3.6 million), an $11.9 million (US$11.5 million) impairment on certain properties and a $15.7 million (US$15.2 million) reversal of a previously recorded impairment loss on property and equipment.

In addition, in December 2013, we decided to sell 11 skilled nursing centers in the U.S. within the next year. Consequently, we recorded an impairment charge of $7.3 million (US$6.8 million) to reduce the net book value of the properties to their estimated fair value.

As for the Canadian operations, based upon the impairment assessment we performed in 2013, we recognized a net pre-tax impairment loss of $0.8 million on certain properties.

The determination of recoverable amounts can be significantly impacted by estimates related to current market valuations, current and future economic conditions in the geographical markets of each CGU, and management's strategic plans within each of its markets. Estimates and assumptions used in the determination of the impairment loss were based upon information that was known at the time, along with future outlook.

In performing the 2013 impairment test on the U.S. operations, the key assumptions used to determine the recoverable amounts were as follows: capitalization rates of 11.8% for nursing centers and 8.5% for assisted living centers; annual maintenance capital expenditures per bed of US$350; and management fees of 5% of revenue. The recoverable amount calculations used discounted pre-tax cash flow projections determined from financial projections based upon both historical and forecasted amounts on which capitalization rates were applied. The calculation was based on the following key assumptions: cash flows were projected based upon historical financial performance along with the forecast impact of Medicare rate reductions in the coming year and past experience on average daily census, factoring in the historical maintenance capital expenditures and management fees; and capitalization rates were based on industry standards on recent transactions.

Based upon this impairment assessment performed in 2013, a 10-basis point increase in the capitalization rate would cause a $0.1 million increase in goodwill impairment of our U.S. operations and no impairment of goodwill on our Canadian operations, assuming all other variables remained constant.

DECOMMISSIONING PROVISIONS

Management has determined that a decommissioning provision exists in the Company's pre-1980 constructed centers for possible asbestos remediation. Although asbestos is currently not a health hazard in any of these centers, appropriate remediation procedures may be required to remove potential asbestos-containing materials, consisting primarily of floor and ceiling tiles, in connection with any major renovation or demolition.

The Company's decommissioning provision, all of which related to asbestos remediation, was $28.8 million at December 31, 2013, compared to $26.9 million at the beginning of the year, with the increase primarily due to the accretion in value. The fair value of the decommissioning provision is estimated by computing the present value of the estimated future costs of remediation based on estimated expected dates of remediation. The computation is based on a number of assumptions, which may vary in the future depending upon the availability of new information, changes in technology and in costs of remediation, and other factors.

The following assumptions were used in calculating the decommissioning provision: (a) discount rates of 6.75% for centers located in Canada and 7.10% for centers located in the U.S.; (b) an estimated timing of the settlement of the provision ranging from 10 to 30 years; and (c) an estimated undiscounted cash flow amount to settle the provision of approximately $50.0 million. There were no changes to the initial timing and estimates of undiscounted cash flow amounts in 2013.

SELF-INSURED LIABILITIES

The Company self-insures for certain risks related to comprehensive general and professional liability (including malpractice insurance), and to a limited degree, workers' compensation (for certain periods), auto liability and health benefits. The Company maintains liability insurance policies through third-party insurers as well as retaining a portion of the risk within its Bermuda-based captive insurance company at a level which the Company believes to be adequate based upon the nature and risks of its business, historical experience and industry standards along with the type of insurance coverage commercially available in the marketplace. The employee related self-insured risks are primarily due within twelve months and, therefore, are included within accrued liabilities as a current liability on an undiscounted basis. The accrual for self-insured liabilities is discounted based upon the projected timing of future payment obligations.

General and professional liability claims are the most volatile and significant type of risks for which the Company self-insures. Furthermore, claim payments for any particular policy year can occur over a period of several years that are limited by state or provincial regulations. The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. The Company estimates the value of losses that may occur within its self-insured retention levels based upon individual assessment of the settlement using historical information and industry data, supported by actuarial projections, advice from legal counsel, consultants and external risk management. Actual results can differ materially from the estimates made due to a number of factors including the assumptions used by management and other market forces.

Management regularly evaluates and periodically engages an independent third-party actuary to provide a report to determine the appropriateness of the carrying value of this liability. Assumptions underlying the determination of the liability are limited by the uncertainty of predicting future events and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; trends in claims along with unique and identifiable settlements; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation. Therefore, management's estimate of the accrual for general and professional liability claims is significantly influenced by assumptions that are subject to judgement by management and the actuary, which may cause the provision to fluctuate significantly from one reporting period to another.

At December 31, 2013, the accrual for self-insured general and professional liabilities was $115.3 million compared to $95.9 million at the beginning of the year. Changes in the level of retained risk and other significant assumptions that underlie management's estimates could have a material effect on the future carrying value of the self-insured liabilities. For example a 1% variance in the accrual for self-insured liabilities at December 31, 2013, would have impacted our net earnings by approximately $1.1 million. For further information refer to the discussion under the heading "Liquidity and Capital Resources – Accrual for Self-Insured Liabilities".

TAX UNCERTAINTIES

Tax uncertainties are evaluated on the basis of whether it is more likely than not that a tax position will ultimately be sustained upon examination by the relevant taxing authorities. Tax uncertainties are measured using a probability adjusted or expected value model whereby amounts are recorded if there is any uncertainty about a filing position, determined by multiplying the amount of the exposure by the probability that the entity's filing position will not be sustained. The assessment of tax uncertainties relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the Company to change its judgement regarding the adequacy of existing tax liabilities. Such changes to tax liabilities will impact tax expense in the period that such a determination is made.

DEFERRED TAX ASSETS AND LIABILITIES

The Company uses the liability method, which takes into account the differences between financial statement treatment and tax treatment of certain transactions, assets and liabilities. Deferred tax assets and liabilities are recognized to reflect the expected future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. With respect to the Company's investment in its foreign subsidiaries, the Company uses the tax rate applicable to dividend distributions, which is based on management's judgement on when the temporary difference will reverse. Deferred tax assets and liabilities are measured using tax rates (enacted or substantially enacted at the reporting date) anticipated to apply in the periods that the temporary differences are expected to be recovered or settled. In assessing whether the deferred tax assets are realizable, management considers whether it is probable (which the Company has defined as "more likely than not") that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. At December 31, 2013, there were capital losses available for Canadian income tax purposes of $20.3 million (2012 – $21.5 million) that can be carried forward indefinitely to apply against future capital gains. No deferred tax assets have been recognized for the future tax benefit of these capital losses of $2.7 million (2012 – $2.9 million).

New Accounting Policies Adopted

Effective January 1, 2013, Extendicare adopted three new accounting amendments and standards issued by the International Accounting Standards Board (IASB): IAS 1 "Presentation of Financial Statements", IFRS 13 "Fair Value Measurement", and IFRS 19 "Post-employment Benefits". These accounting standards are summarized below, and are more fully described in *note 4* of the 2013 consolidated financial statements.

Other new accounting amendments and standards effective commencing this year include: IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements and Consolidated Financial Statements", and IFRS 12 "Disclosure of Interests in Other Entities and Consolidated Financial Statements". The adoption of these standards effective January 1, 2013, did not impact Extendicare's financial position, earnings or cash flows.

PRESENTATION OF FINANCIAL STATEMENTS – OTHER COMPREHENSIVE INCOME

Amendments to IAS 1 "Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income" require entities to segregate items within other comprehensive income (OCI) that may eventually be recognized in our results of operations from those that will not. As these amendments only required changes in the presentation of items in OCI, the impact of adoption did not have a material impact on the financial position, earnings or cash flows.

FAIR VALUE MEASUREMENT

IFRS 13 "Fair Value Measurement" is a new standard that replaces the fair value measurement guidance contained in individual standards with a single source of fair value measurement guidance. For additional details, see *notes 4, 14* and *27(b)* to the 2013 consolidated financial statements. The application of this new standard did not have a material impact on the financial position or results of operations.

POST-EMPLOYMENT BENEFITS

The amended version of IAS 19 "Employee Benefits" requires: actuarial gains and losses be recognized immediately in OCI; the expected rate of return on plan assets to be the same as the discount rate on the defined benefit obligation; and enhanced disclosures. For additional details, see *note 4* to the 2013 consolidated financial statements. There was no material impact on the adoption of these amendments as the Company had already elected to immediately recognize actuarial gains and losses in OCI, and the plan assets are not material.

Future Change in Accounting Policies

The following new standards, amendments to standards and interpretations are effective for annual periods beginning on or after January 1, 2014, and have not been applied in preparing the financial results for the year ended December 31, 2013.

FINANCIAL INSTRUMENTS

IFRS 9 "Financial Instruments", which replaces IAS 39 "Financial Instruments: Recognition and Measurement", addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 replaces the four categories of financial assets as required by IAS 39 with two measurement categories, as follows: (i) those measured at fair value; and (ii) those measured at amortized cost. Changes in fair value will be recorded in net earnings under IFRS 9 instead of through OCI under IAS 39. For financial liabilities measured at fair value, fair value changes due to changes in the Company's credit risk are presented in OCI instead of through net earnings unless this would create an accounting mismatch. The date of application has not been determined. The Company is assessing the potential impact of this standard.

FINANCIAL INSTRUMENTS: PRESENTATION – OFFSETTING FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Amendments to IAS 32, which establishes disclosure requirements that are intended to help clarify for financial statement users the effect or potential effect of offsetting arrangements on an entity's financial position. These amendments are effective for the annual period beginning on January 1, 2014. The Company is in the process of assessing the impact of the adoption of these amendments, and does not expect that they will have a material impact on its consolidated financial statements.

LEVIES

IFRS 21 "Levies" clarifies that an entity recognizes the full amount of a liability for a levy during the period in which the activity that triggers payment occurs, as identified by the relevant legislation, instead of amortizing the expense over a period of time. This standard is effective for annual periods beginning on or after January 1, 2014. The Company is in the process of assessing the impact of the adoption of this interpretation on its consolidated financial statements.

Disclosure Controls and Procedures

Disclosure Controls and Procedures (DC&P) are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the DC&P was conducted as at December 31, 2013, by management under the supervision of the Company's CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that as at December 31, 2013, our disclosure controls and procedures, as defined by National Instrument 52-109, Certification of Disclosures in Issuers' Annual and Interim Filings, are effective.

Internal Control over Financial Reporting

Internal Control over Financial Reporting (ICFR) is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP. Management, under the supervision of the Company's CEO and CFO, has evaluated the effectiveness of our ICFR using the original framework and criteria established by the Committee of Sponsoring Organizations of the Treadway Commission in 1992. Based on this evaluation, management has concluded that our ICFR was effective and that there were no material weaknesses in our ICFR as at December 31, 2013.

ADDITIONAL INFORMATION

Additional information about Extendicare, including its Annual Information Form for the year ended December 31, 2013, may be found on the SEDAR website at www.sedar.com and on Extendicare's website at www.extendicare.com. A copy of this document and other public documents of Extendicare are available upon request to the Corporate Secretary of Extendicare.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The accompanying consolidated financial statements of Extendicare Inc. ("Extendicare" or the "Company"), formerly "Extendicare Real Estate Investment Trust", and other financial information contained in this Annual Report are the responsibility of management. The consolidated financial statements have been prepared in conformity with International Financial Reporting Standards, using management's best estimates and judgements, where appropriate. In the opinion of management, these consolidated financial statements reflect fairly the financial position, results of operations and cash flows of Extendicare within reasonable limits of materiality. The financial information contained elsewhere in this Annual Report has been reviewed to ensure consistency with that in the consolidated financial statements.

A system of internal accounting and administrative controls is maintained by management to provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that financial records are properly maintained to provide accurate and reliable financial statements.

The board of directors of Extendicare (the "Board of Directors") is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Board of Directors carries out this responsibility principally through its independent Audit Committee comprised of unrelated and outside directors. The Audit Committee meets regularly during the year to review significant accounting and auditing matters with management and the independent auditors and to review and approve the interim and annual consolidated financial statements of Extendicare.

The consolidated financial statements have been audited by KPMG LLP, Chartered Accountants, which has full and unrestricted access to the Audit Committee. KPMG's report on the consolidated financial statements follows.

Timothy L. Lukenda
President and Chief Executive Officer

Dylan T. Mann
Senior Vice President and
Chief Financial Officer

February 26, 2014

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Extendicare Inc.

We have audited the accompanying consolidated financial statements of Extendicare Inc. ("Extendicare" or the "Company"), which comprise the consolidated statements of financial position as at December 31, 2013, and December 31, 2012, and the consolidated statements of earnings, comprehensive income, changes in equity, and cash flows for the years ended December 31, 2013 and 2012, and a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Extendicare as at December 31, 2013, and December 31, 2012, and the financial performance and its cash flows for the years ended December 31, 2013 and 2012, in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants,
Licensed Public Accountants

February 26, 2014
Toronto, Canada

Consolidated Statements of Financial Position

(in thousands of Canadian dollars)

As at December 31	*notes*	**2013**	2012
Assets			
Current assets			
Cash and short-term investments		**95,999**	71,398
Restricted cash	*14*	**18,668**	28,680
Accounts receivable	*6*	**210,795**	209,518
Income taxes recoverable		**9,395**	4,149
Other current assets	*7, 8*	**61,893**	31,408
Total current assets		**396,750**	345,153
Non-current assets			
Property and equipment	*9*	**1,152,007**	1,181,596
Goodwill and other intangible assets	*10*	**79,229**	82,793
Other assets	*11*	**213,571**	176,457
Deferred tax assets	*24*	**7,531**	21,917
Total non-current assets		**1,452,338**	1,462,763
Total Assets	*30*	**1,849,088**	1,807,916
Liabilities and Equity			
Current liabilities			
Accounts payable and accrued liabilities	*8, 12*	**245,745**	238,421
Income taxes payable		**10,430**	9,377
Long-term debt	*14*	**148,051**	93,448
Provisions	*13*	**28,052**	21,888
Total current liabilities		**432,278**	363,134
Non-current liabilities			
Long-term debt	*14*	**1,016,785**	1,038,787
Provisions	*13*	**116,058**	100,893
Other long-term liabilities	*15*	**46,147**	48,025
Deferred tax liabilities	*24*	**199,954**	202,417
Total non-current liabilities		**1,378,944**	1,390,122
Total liabilities	*30*	**1,811,222**	1,753,256
Share capital	*16*	**476,480**	467,463
Equity portion of convertible debentures	*14*	**5,573**	5,573
Contributed surplus		**48**	48
Accumulated deficit		**(441,794)**	(395,024)
Accumulated other comprehensive loss		**(2,441)**	(23,400)
Shareholders' equity		**37,866**	54,660
Total Liabilities and Equity		**1,849,088**	1,807,916

See accompanying notes to consolidated financial statements.

Subsequent events *(notes 14 and 20)*.

Commitments and contingencies *(note 25)*.

Approved by the Board

Benjamin J. Hutzel
Chairman

Timothy L. Lukenda
President and Chief Executive Officer

Consolidated Statements of Earnings

(in thousands of Canadian dollars except for per share amounts)

Years ended December 31	*notes*	**2013**	2012
CONTINUING OPERATIONS			
Revenue			
Nursing and assisted living centers			
United States		**1,216,569**	1,259,858
Canada		**568,870**	550,302
Home health care – Canada		**174,087**	170,343
Health technology services – United States		**22,348**	25,453
Outpatient therapy – United States		**13,360**	13,229
Rent, management, consulting and other services		**29,231**	18,228
Total revenue	*18*	**2,024,465**	2,037,413
Operating expenses		**1,793,368**	1,780,019
Administrative costs		**64,258**	63,155
Lease costs		**11,096**	10,986
Total expenses	*19*	**1,868,722**	1,854,160
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items		**155,743**	183,253
Depreciation and amortization		**77,929**	76,805
Loss from asset impairment, disposals and other items	*20*	**9,641**	7,930
Earnings before net finance costs and income taxes		**68,173**	98,518
Interest expense		**63,416**	65,306
Accretion of decommissioning provisions		**1,823**	1,694
Other accretion		**1,557**	608
Loss on foreign exchange and financial instruments		**519**	1,103
Finance costs		**67,315**	68,711
Interest revenue		**4,638**	3,565
Fair value adjustments		**3,099**	4,823
Finance income		**7,737**	8,388
Net finance costs	*21*	**59,578**	60,323
Earnings before income taxes		**8,595**	38,195
Income tax expense (recovery)			
Current		**4,547**	5,178
Deferred		**(1,204)**	5,394
Total income tax expense	*24*	**3,343**	10,572
Earnings from continuing operations		**5,252**	27,623
DISCONTINUED OPERATIONS			
Earnings from discontinued operations, net of income taxes	*23, 24*	–	35,033
Net earnings attributable to shareholders of the company		**5,252**	62,656
Basic Earnings per Share			
Earnings from continuing operations	*22*	**0.06**	0.32
Net earnings	*22*	**0.06**	0.74
Diluted Earnings per Share			
Earnings from continuing operations	*22*	**0.06**	0.32
Net earnings	*22*	**0.06**	0.68

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income

(in thousands of Canadian dollars)

Years ended December 31	*notes*	**2013**	2012
Net earnings		**5,252**	62,656
Other comprehensive income (loss), net of income taxes			
Items that will not be reclassified to profit or loss:			
Defined benefit plan actuarial loss, net of tax	*26*	**(168)**	(985)
Total items that will not be reclassified to profit or loss		**(168)**	(985)
Items that are or may be reclassified subsequently to profit or loss:			
Unrealized gain on available-for-sale securities, net of tax	*17*	**2,882**	1,505
Reclassification of realized gain on available-for-sale securities to earnings, net of tax	*17*	**(335)**	(315)
Net change in foreign currency translation adjustment	*17*	**18,580**	(4,867)
Total items that are or may be reclassified subsequently to profit or loss		**21,127**	(3,677)
Other comprehensive income (loss), net of taxes		**20,959**	(4,662)
Total comprehensive income		**26,211**	57,994

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

(in thousands of Canadian dollars)

Years ended December 31	*notes*	**2013**	2012
Share/unit capital			
Unit capital, at January 1		–	453,150
DRIP		–	7,112
2012 Conversion	*1, 16*	–	(460,262)
Unit capital, end of year		–	–
Share capital, at January 1		**467,463**	–
DRIP		**9,017**	7,275
Purchase of shares for cancellation in excess of book value		–	(74)
2012 Conversion	*1, 16*	–	460,262
Share capital, end of year		**476,480**	467,463
Balance at end of year		**476,480**	467,463
Equity portion of convertible debentures			
Balance at January 1		**5,573**	–
Issuance of convertible debentures		–	5,573
Balance at end of year		**5,573**	5,573
Contributed surplus			
Balance at January 1		**48**	81
Purchase of shares for cancellation in excess of book value		–	(33)
Balance at end of year		**48**	48
Accumulated deficit			
Balance at January 1		**(395,024)**	(386,174)
Net earnings		**5,252**	62,656
Dividends/distributions declared		**(52,022)**	(71,497)
Other		–	(9)
Balance at end of year		**(441,794)**	(395,024)
Accumulated other comprehensive loss			
Balance at January 1		**(23,400)**	(18,738)
Other comprehensive income (loss):			
Foreign currency translation differences for foreign operations		**18,580**	(4,867)
Net change in fair value of available-for-sale financial assets, net of tax		**2,882**	1,505
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of tax		**(335)**	(315)
Defined benefit plan actuarial losses, net of tax		**(168)**	(985)
Total other comprehensive income (loss)		**20,959**	(4,662)
Balance at end of year		**(2,441)**	(23,400)
Shareholders' equity		**37,866**	54,660

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in thousands of Canadian dollars)

Years ended December 31	**2013**	2012
Operating Activities		
Net earnings	**5,252**	62,656
Adjustments for:		
Depreciation and amortization	**77,929**	76,805
Accrual for self-insured liabilities in provisions	**54,482**	40,807
Payments for self-insured liabilities in provisions	**(42,720)**	(23,933)
Deferred taxes	**(1,204)**	5,263
Current taxes	**4,547**	26,729
Loss from asset impairment, disposals and other items	**9,641**	7,930
Gain from asset disposals from discontinued operations	**–**	(56,453)
Net finance costs	**59,578**	60,323
Interest capitalized	**(1,232)**	(873)
Other	**(335)**	(406)
	165,938	198,848
Net change in operating assets and liabilities		
Accounts receivable	**6,246**	21,111
Other current assets	**4,541**	759
Accounts payable and accrued liabilities	**(15,882)**	(31,701)
	160,843	189,017
Interest paid	**(59,585)**	(60,276)
Interest received	**4,657**	3,509
Income taxes paid	**(7,999)**	(23,463)
Net cash from operating activities	**97,916**	108,787
Investing Activities		
Purchase of property, equipment and software	**(55,753)**	(84,103)
Net proceeds from dispositions	**3,671**	56,323
Decrease (increase) of other assets	**1,646**	(5,363)
Net cash from investing activities	**(50,436)**	(33,143)
Financing Activities		
Issue of long-term debt, excluding line of credit	**95,703**	329,720
Repayment of long-term debt, excluding line of credit	**(84,101)**	(254,468)
Issue on line of credit	**–**	63,964
Repayment on line of credit	**(6,179)**	(108,846)
Decrease (increase) in restricted cash	**9,799**	(11,832)
Decrease (increase) in investments held for self-insured liabilities	**6,908**	(31,603)
Dividends/distributions paid	**(45,534)**	(56,980)
Financing costs	**(2,065)**	(13,101)
Other	**5**	(4)
Net cash from financing activities	**(25,464)**	(83,150)
Increase (decrease) in cash and short-term investments	**22,016**	(7,506)
Cash and short-term investments at beginning of year	**71,398**	80,018
Foreign exchange gain (loss) on cash held in foreign currency	**2,585**	(1,114)
Cash and short-term investments at end of year	**95,999**	71,398

See accompanying notes to consolidated financial statements.

Cash distributions for Extendicare are at the discretion of the Board.

Years ended December 31, 2013 and 2012

TABLE OF CONTENTS

Years ended December 31, 2013 and 2012
(Tabular amounts in thousands of Canadian dollars, unless otherwise noted)

1. GENERAL INFORMATION AND NATURE OF THE BUSINESS

Extendicare Inc. ("Extendicare" or the "Company") is the successor to Extendicare Real Estate Investment Trust ("Extendicare REIT" or the "REIT") following the conversion of the REIT from an income trust to a corporate structure pursuant to a plan of arrangement effective July 1, 2012 (the "2012 Conversion"). The 2012 Conversion was accounted for by the Company as a continuity of interest, and accordingly, the consolidated financial statements of the Company are reflective as if the Company had always carried on the business previously carried on indirectly by Extendicare REIT *(note 16)*. Comparative information for Extendicare relating to periods prior to the 2012 Conversion is that of its predecessor, Extendicare REIT.

References to "Extendicare", the "Company", "we", "us" and "our" or similar terms refer to Extendicare Inc., either alone, or together with its subsidiaries. The registered office of Extendicare is located at 3000 Steeles Avenue East, Markham, Ontario, Canada, L3R 9W2. The common shares of Extendicare Inc. (the "Common Shares") commenced trading on the Toronto Stock Exchange (TSX) on July 5, 2012, under the trading symbol "EXE" and the units of Extendicare REIT (the "REIT Units") were de-listed concurrently.

Extendicare is a leading North American provider of long-term senior care services offering post-acute, rehabilitative therapies and long-term care through its network of owned and operated senior care centers that include skilled nursing centers in the United States and nursing centers in Canada. Extendicare itself is not a provider of services or products. The operation of the senior care centers and ancillary businesses is conducted by the subsidiaries of Extendicare, namely its wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), and its wholly owned Canadian subsidiary, Extendicare (Canada) Inc. and its subsidiaries (collectively "ECI").

2. BASIS OF PREPARATION

a) Statement of Compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). The Company transitioned to IFRS as at January 1, 2010 (the "Transition Date"). Periods prior to January 1, 2010, were reported under previous Canadian generally accepted accounting principles (GAAP).These consolidated financial statements were approved by the board of directors of Extendicare Inc. (the "Board") on February 26, 2014.

b) Basis of Measurement

The consolidated financial statements have been prepared on the historical cost basis except for financial assets and liabilities classified or designated at fair value through profit or loss (FVTPL) or designated as available for sale (AFS) that have been measured at fair value. Refer to *note 3* for the classification of financial assets and liabilities.

Extendicare's consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. All financial information presented in dollars has been rounded to the nearest thousand, unless otherwise noted.

c) Use of Estimates and Judgement

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The more subjective of such estimates and judgement are:

- revenue recognition *(note 18);*
- valuation of accounts receivable *(notes 6 and 27(a));*
- determination of the recoverable amount of cash generating units (CGUs) subject to an impairment test *(notes 10 and 20);*
- valuation of decommissioning provisions *(note 13);*

- valuation of self-insured liabilities *(note 13);*
- assessment of contingencies *(note 25);*
- valuation of financial assets and liabilities *(note 27(b));*
- valuation of share appreciation rights liabilities *(note 15);* and
- accounting for tax uncertainties and the tax rates used for valuation of deferred taxes *(note 24)*.

The recorded amounts for such items are based on management's best available information and are subject to assumptions and judgement, which may change as time progresses; accordingly, actual results could differ from estimates.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

a) Basis of Consolidation

The consolidated financial statements include the accounts of Extendicare and its subsidiaries. All material intercompany transactions and balances have been eliminated. The financial statements of Extendicare's subsidiaries are included within the Company's consolidated financial statements from the date that control commences until the date that control ceases, and are prepared for the same reporting period as Extendicare, using consistent accounting policies.

The acquisition method of accounting is used to account for the acquisition of subsidiaries. Consideration transferred on the acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed on the date of the acquisition and transaction costs are expensed as incurred. Identified assets acquired and liabilities assumed are generally measured at their fair value on the acquisition date. In determining the fair value of identifiable intangible assets acquired, values are assigned to resident relationships as described in *note 3(h)*. The excess of fair value of consideration given over the fair value of the identifiable net assets acquired is recorded as goodwill, with any negative goodwill being recognized in net earnings on the acquisition date.

b) Foreign Currency

FOREIGN OPERATIONS

The assets and liabilities of foreign operations are translated at exchange rates at the reporting date. The income and expenses of foreign operations are translated at average rates of exchange for the period. The resulting translation adjustments are included in accumulated other comprehensive income (AOCI) in shareholders' equity. When a foreign operation is disposed of, the relevant amount in the cumulative amount of foreign currency translation differences is transferred to net earnings as part of the profit or loss on disposal. When only part of the interest in a subsidiary that includes a foreign operation is disposed of, the relevant proportion of such cumulative amount is reattributed to non-controlling interest. Foreign exchange gains and losses related to intercompany loans that are, in substance, part of the net investment in a foreign operation are included in AOCI. Foreign exchange gains and losses on intercompany loans with planned or foreseeable settlement are included in net finance costs within net earnings.

FOREIGN CURRENCY TRANSACTIONS

Transactions in foreign currencies are translated at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognized in net earnings, except for differences arising on the retranslation of available-for-sale equity instruments, which are recognized in other comprehensive income (OCI). Non-monetary items that are measured at historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign exchange gains and losses are included in net finance costs within net earnings.

c) Cash and Short-term Investments

Cash and cash equivalents include unrestricted cash and short-term investments less bank overdraft and outstanding cheques. Short-term investments, comprised of money market instruments, have a maturity of 90 days or less from their date of purchase.

d) Accounts Receivable

Receivables from government agencies represent the only concentrated group of accounts receivable for EHSI and ECI. In the United States, EHSI has receivables from federal and state medical assistance programs, other third-party payors and from individuals. In Canada, ECI has receivables primarily from provincial government agencies. Management does not believe there is any credit risk associated with these government agencies other than possible funding delays. Accounts receivable other than from government agencies consist of receivables from Managed Care providers, commercial insurers and private individuals that are subject to different economic conditions, none of which represents any concentrated credit risk to the Company.

Extendicare periodically evaluates the adequacy of its provision for receivable impairment by conducting a specific account review of amounts in excess of predefined target amounts and aging thresholds, which vary by payor type. Allowances for uncollectibility are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, the Company has established percentages for provision for receivable impairment that are based upon historical collection trends for each payor type and age of the receivables. Accounts receivable that are specifically estimated to be uncollectible, based upon the above process, are fully reserved for in the provision for receivable impairment until they are written off or collected.

e) Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition or development of the asset. Property and equipment acquired as a result of a business combination are valued as outlined in *note 3(a)*. Centers that are constructed or that are in progress include all incurred expenditures for the development and other direct costs related to the acquisition of land, development and construction of the centers, including borrowing costs of assets meeting certain criteria that are capitalized until the center is completed for its intended use.

Refer to *note 3(i)* for the accounting policy for the determination of impairment losses.

Property and equipment are classified into components when parts of an item have different useful lives. The cost of replacing a component of an item is recognized in the carrying amount of the item if there is a future economic benefit and its cost can be measured reliably. Any undepreciated carrying value of the assets being replaced will be derecognized and charged to net earnings upon replacement. The costs of the day-to-day maintenance of property and equipment are recognized in net earnings as incurred.

Depreciation and amortization are computed on a straight-line basis based on the useful lives of each component of property and equipment. Depreciation of nursing centers under construction commences in the month after the center is available for its intended use based upon the useful life of the asset, as outlined in the following table. The depreciation methods, useful lives and residual values are reviewed at least annually, and adjusted if appropriate.

Land improvements	10 to 25 years
Buildings:	
Building components:	
Structure and sprinklers systems	50 years
Roof, windows and elevators	25 years
HVAC and building systems	15 to 25 years
Flooring and interior upgrades	5 to 15 years
Building improvements and extensions	5 to 30 years
Furniture and equipment:	
Furniture and equipment	5 to 15 years
Computer equipment	3 to 5 years
Leasehold improvements	Term of the lease and renewal that is reasonably certain to be exercised

f) Government Grants

Government grants are recognized depending on the purpose and form of the payment from the government.

Forgivable loans issued by the government are accounted for as government grants if there is reasonable assurance the Company will meet the terms for forgiveness of the loan. Forgivable loans granted by a provincial or health authority body for the construction of a senior care center, where the grants are received throughout the duration of the construction project, are netted with the cost of property and equipment to which they relate when such payments are received.

Capital funding payments for the development of a senior care center that are received from a provincial body subsequent to construction over extended periods of time are present valued and are recorded as notes, mortgages and amounts receivable included in other assets, with an offset to the cost of property and equipment upon inception; as these grants are received over time, the accretion of the receivables are recognized in interest revenue as part of net finance costs within net earnings.

g) Leases

Leases are classified as either finance or operating leases. Leases that substantially transfer all of the benefits and risks of ownership of property to the lessee, or otherwise meet the criteria for capitalizing a lease under IFRS, are accounted for as a finance lease; all other leases are classified as operating leases.

WHEN THE COMPANY IS THE LESSEE

Leased assets that are classified as finance leases are presented according to their nature and are measured at amounts equal to the lower of their fair value and the present value of the minimum lease payments. The corresponding liability due to the lessor is presented as a finance lease obligation as part of the long-term debt. Property and equipment recognized as finance leases are depreciated on a consistent basis with owned property and equipment.

Rental payments under operating leases are expensed as incurred. Operating leases with defined scheduled rent increases are recognized on a straight-line basis over the lease term. Lease incentives received as an inducement to enter into operating leases are initially recognized as a liability, and are recorded as a reduction of rental expense on a straight-line basis over the term of the lease.

WHEN THE COMPANY IS THE LESSOR

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Company's net investment in the leases. The interest element of the lease payment is recognized over the term of the lease based on the effective interest method and is included in financing costs. The Company is not currently the lessor under any finance leases.

Assets under operating leases are included in property and equipment. Rental income from operating leases is recognized on a straight-line basis over the term of the lease and is included in revenue from rental, management, consulting and other services.

h) Goodwill and Other Intangible Assets

GOODWILL

Goodwill represents the excess amount of consideration given over the fair value of the underlying net assets acquired in a business combination, and is measured at cost less accumulated impairment losses. Goodwill arising from acquisitions prior to January 1, 2010, is included on the basis of its deemed cost, which represents the amount recorded under previous Canadian GAAP, subject to an impairment test on the Transition Date. Goodwill is not amortized, but is tested for impairment on an annual basis or more frequently if there are indicators that goodwill may be impaired, see *note 3(i)*.

OTHER INTANGIBLE ASSETS

Other intangible assets that are acquired and have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses (refer to *note 3(i)*). Intangible assets with finite lives are amortized based on cost. Subsequent expenditures are capitalized only if a future benefit exists. All other expenditures, including expenditures on internally generated goodwill, are recognized in net earnings as incurred.

Intangible assets with indefinite useful lives are measured at cost without amortization, and are subject to impairment tests (refer to *note 3(i))*.

Purchased licenses for resident relationships acquired through the acquisition of senior care centers are intangible assets. Acquiring resident relationships for existing residents of acquired centers represent the cost of having to obtain new residents. These intangible assets include a value of lost net resident revenue over the estimated lease-up period of the property, and are amortized on a straight-line basis, based upon a review of the residents' average length of stay. Resident relationships are generally amortized over a 16-month period for senior care centers. Amortization of the resident relationships asset is included within amortization expense in net earnings.

Non-compete agreements acquired through acquisitions are amortized on a straight-line basis over the period until the agreement expires.

Computer software is amortized over five to seven years and internally developed software over a three-year period.

Amortization methods and useful lives are reviewed at least annually, and are adjusted when appropriate.

i) Impairment

Impairment of financial and non-financial assets is assessed on a regular basis. All impairment losses are charged to loss (gain) from asset impairment, disposals and other items as part of earnings before net finance costs and income taxes.

NON-FINANCIAL ASSETS

Non-financial assets consist of property and equipment, intangible assets with finite lives, intangible assets with indefinite lives and goodwill.

The carrying amounts of non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated annually at the same time or more frequently if warranted. An impairment loss is recognized in net earnings if the carrying amount of an asset or its related CGU, or group of assets on the same basis as evaluated by management, exceeds its estimated recoverable amount. A CGU is defined to be the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets. The Company has identified each individual center as a CGU.

The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. Goodwill and indefinite life intangible assets are allocated to their respective CGUs for the purpose of impairment testing. Indefinite life intangible assets and corporate assets that do not generate separate cash flows and are utilized by more than one CGU, are allocated to each CGU for the purpose of impairment testing and are not tested for impairment separately.

Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the assets in the CGU on a pro rata basis. Impairment losses on goodwill cannot be reversed. In respect of other non-financial assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

FINANCIAL ASSETS

A financial asset is any asset that consists of: cash; a contractual right to receive cash or another financial asset, or exchange financial assets or financial liabilities under potentially favourable conditions; an equity instrument of another entity; or certain contracts that will or may be settled in the Company's own equity instruments.

Financial assets are reviewed at each reporting date and are deemed to be impaired when objective evidence resulting from one or more events subsequent to the initial recognition of the asset indicates the estimated future cash flows of the asset has been negatively impacted. For assets carried at amortized cost or cost and debt securities, the criteria of this assessment includes significant financial difficulty of the issuer or obligor, the disappearance of an active market for that financial asset because of financial difficulties, or observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets. For equity investments classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is also objective evidence that the assets are impaired.

For assets carried at amortized cost or cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate, and will be recognized in net earnings. Impairment losses can be reversed to the extent it was previously recognized in net earnings.

For assets classified as available for sale, the cumulative impairment loss is the difference between the asset's carrying amount and the fair value plus any losses accumulated in the OCI. Impairment losses on equity instruments cannot be reversed, whereas impairment losses on debt instruments can be reversed to the extent they were previously recognized in net earnings.

j) Investments Held for Self-insured Liabilities

Extendicare, through its captive insurance subsidiary, holds investments as security for self-insured liabilities. The majority of these investments are investment grade. These investments are classified as available for sale. Investments held for sale are designated as available for sale and are valued at fair market value through OCI, and held-to-maturity investments are valued at amortized cost. (Refer to *note 3(o))*.

k) Employee Benefits

DEFINED BENEFIT PLANS

Defined benefit plans are post-employment plans with a defined obligation to employees in return for the services rendered during the term of their employment with the Company. The net obligation of these plans is calculated separately for each plan by estimating the present value of future benefit that employees have earned in return for their service in the current and prior periods. Any unrecognized past service costs and the fair value of any plan assets are deducted. The discount rate used in deriving the present value is the yield at the reporting date on AA credit-rated corporate bonds that have maturity dates approximating the Company's obligations and are denominated in the same currency in which the benefits are expected to be paid.

The calculation of the future benefit of the plan is performed annually by a qualified actuary using the project unit credit method. When the calculation results in a benefit to the plan, the recognized asset is limited to the total of any unrecognized past service costs and the present value of economic benefits available in the form of reductions in future contributions to the plan.

All actuarial gains and losses arising from defined benefit plans are recognized in OCI during the period in which they are incurred.

DEFINED CONTRIBUTION PLANS

The Company has corporate specific and multi-employer defined benefit pension plans, as well as deferred compensation plans. Multi-employer defined benefit pension plans are accounted for as defined contribution plans as the liability per employer is not available. Deferred compensation plans are also accounted for as defined contribution plans. Defined contribution plans are post-employment plans where the costs are fixed and there are no legal or constructive obligations to pay further amounts. Obligations for such contributions are recognized as employee benefit expense in net earnings during the periods in which services are rendered by employees.

SHORT-TERM EMPLOYEE BENEFITS

The Company has vacation, paid sick leave and short-term disability plans along with other health, drug and welfare plans for its employees. These employee benefit obligations are measured on an undiscounted basis and are expensed as the related services are rendered.

OTHER EMPLOYEE BENEFITS

The Company self-insures, to a limited degree, certain risks in EHSI including workers' compensation (for certain periods), auto liability and health benefits. These employee related self-insured risks are primarily due within twelve months and therefore are not discounted and are included within accounts payable and accrued liabilities as a current liability.

l) Share Appreciation Rights Plan

Awards under the Company's share appreciation rights plan (the "SARP") have a three-year vesting period. Until the liability is settled, the Company reports the liability on a pro rata basis at fair value at each reporting date. The fair value of the share appreciation right (SAR) is determined by using an option pricing model based on the remaining vesting term and the amount by which the "Fair Market Value" of a Common Share of Extendicare exceeds the grant price, plus "Accrued Distributions". "Fair Market Value" of a Common Share, on any particular date, means the volume-weighted average trading price of the Common Share on the TSX for the 10 trading days immediately preceding such date. "Accrued Distributions" means the product of the aggregate amount of cash distributions per Common Share declared payable to holders of record during the term of the SAR and the probability of the award being in the money at the end of the vesting period. Changes in fair value are recognized in net earnings in the period during which these are incurred.

m) Provisions

A provision is recognized when there is a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and that obligation can be measured reliably. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as accretion and recognized as part of net finance costs. Provisions are reviewed on a regular basis and adjusted to reflect management's best current estimates. Due to the judgemental nature of these items, future settlements may differ from amounts recognized. Provisions comprise estimated self-insured liabilities, decommissioning provisions and other legal claims and obligations.

SELF-INSURED LIABILITIES

Extendicare self-insures certain risks related to general and professional liability. The accrual for self-insured liabilities includes the estimated costs of both reported claims and claims incurred but not yet reported. The provision for self-insured liabilities is based on estimates of loss based upon assumptions made by management supported by actuarial projections and the advice of external risk management and legal counsel. The accrual for self-insured liabilities is discounted based on the projected timing of future payment obligations.

DECOMMISSIONING PROVISIONS

Management has determined that future costs could be incurred for possible asbestos remediation of the Company's pre-1980 constructed centers. Although asbestos is currently not a health hazard in any of these centers, appropriate remediation procedures may be required to remove potential asbestos-containing materials, consisting primarily of floor and ceiling tiles, in connection with any major renovation or demolition.

The fair value of the decommissioning provision related to asbestos remediation is estimated by computing the present value of the estimated future costs of remediation based on estimated expected dates of remediation. The computation is based on a number of assumptions, which may vary in the future depending upon the availability of new information, changes in technology and in costs of remediation, and other factors.

The following assumptions were used in calculating the decommissioning provision: (a) discount rates of 6.75% for ECI and 7.10% for EHSI; (b) an estimated timing of the settlement of the provision ranging from 10 to 30 years since the provision was established in 2005; and (c) an estimated undiscounted cash flow amount to settle the decommissioning provision of approximately $50 million.

OTHER PROVISIONS

Other provisions include legal claims that meet the above definition of a provision, along with lease restructuring and employee termination payments. Provisions are not recognized for future operating losses.

n) Fair Value Measurement

Extendicare measures financial instruments at fair value at each balance sheet date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either: in the principal market for the asset or liability; or in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Company. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability assuming that market participants act in their economic best interests.

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the following fair value hierarchy:

Level 1 – quoted (unadjusted) market prices in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); or

Level 3 – unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement in its entirety, categorization of which is re-assessed at the end of each reporting period. For the purpose of fair value disclosures, the Company has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

o) Financial Instruments

FINANCIAL ASSETS AND LIABILITIES

Extendicare classifies financial assets and liabilities according to their characteristics and the related management's intention for use on an ongoing basis. Financial assets and liabilities are classified into one of the following five classifications: held-to-maturity financial assets, loans and receivables, financial assets at FVTPL, AFS and financial liabilities. Below is a description of the valuation methodology.

Held-to-maturity Financial Assets

Held-to-maturity financial assets are those that the Company has the positive intent and ability to hold to maturity. Held-to-maturity financial assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, held-to-maturity financial assets are measured at amortized cost using the effective interest method, less any impairment losses. Any sale or reclassification of a more than insignificant amount of held-to-maturity investments not close to their maturity would result in the reclassification of all held-to-maturity investments as available-for-sale investments, and prevent the Company from classifying investment securities as held to maturity for the current and the following two financial years.

Loans and Receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Financial Assets at FVTPL

Assets classified as FVTPL are financial assets that are acquired for the purpose of selling in the short term. These assets are initially recognized and subsequently carried at fair value with changes recorded in net earnings and all transaction costs are expensed as incurred.

AFS

AFS financial assets are assets that are not classified in any of the previous categories or are designated as such by management. These assets are initially recognized at fair value plus transaction costs, and subsequently carried at fair value with changes, except for impairment losses, recorded in OCI until the assets are derecognized through sale or impairment, at which time the cumulative gain or loss previously recognized in AOCI is recognized in net earnings. Interest calculated using the effective interest method on available-for-sale financial assets is recognized in net earnings. Dividends on available-for-sale equity instruments are recognized in net earnings when Extendicare's right to receive payment is established.

Financial Liabilities

Financial liabilities include FVTPL and other financial liabilities, these are liabilities incurred or assumed in the conduct of business or specific transactions. Financial liabilities are initially measured at fair value and subsequently measured at either amortized cost or fair value. Financial liabilities that are designated as FVTPL are subsequently measured at fair value with changes recognized in net earnings as part of finance costs, whereas those that are designated as other financial liabilities are subsequently measured at amortized cost.

The Company has convertible debentures that can be converted to Common Shares at the option of the holder and the number of Common Shares to be issued does not vary with changes in fair value. Those convertible debentures that were issued prior to the 2012 Conversion are designated as financial liabilities valued at FVTPL, whereas those issued subsequent to the 2012 Conversion are classified as other financial liabilities.

Summary of Financial Instruments and Classification

All of the Company's financial instruments are classified as loans and receivables, AFS, other financial liabilities or financial liabilities valued at FVTPL.

Below is a classification summary of the Company's financial instruments:

Asset / Liability	Classification	Measurement
Cash and short-term investments	Loans and receivables	Amortized cost
Total receivables	Loans and receivables	Amortized cost
Notes, mortgages and amounts receivable	Loans and receivables	Amortized cost
Investments held for self-insured liabilities – Available for sale	AFS	Fair value
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Long-term debt excluding convertible debentures issued prior to 2012 Conversion	Other financial liabilities	Amortized cost
Convertible debentures issued prior to 2012 Conversion	FVTPL	Fair value

Other items on the statement of financial position including, but not limited to, prepaid expenses within other current assets, property and equipment, goodwill and intangible assets, deferred income taxes, provisions and employee benefit obligations are not financial assets or liabilities.

DERIVATIVE FINANCIAL INSTRUMENTS

From time to time, the Company uses derivative financial instruments to manage risks from fluctuations in exchange rates and interest rates. All derivative instruments, including embedded derivatives that must be separately accounted for, are valued at their respective fair values in the consolidated financial statements unless they are effective cash-flow hedging instruments.

On the date a derivative contract is entered into, the Company assesses whether or not to designate the derivative (or non-derivative) as either a hedge of the fair value of a recognized asset or liability (a "fair-value hedge") or a hedge of the variability of cash flows to be received or paid related to a recognized asset or liability or a forecasted transaction (a "cash-flow hedge") or as a hedge of a net investment in a foreign operation. At the inception of any hedge and on an ongoing basis, we assess whether the derivatives that are used in the hedging transactions are highly effective in offsetting changes in fair values or cash flows of the hedged items. We currently do not have any fair-value, cash-flow or net investment hedges.

Management uses foreign currency forward contracts (FCFCs) to limit the exposure of converting U.S. cash flow into Canadian dollars. These are not designated as fair-value or cash-flow hedges for accounting purposes; therefore, gains or losses arising from the change in fair values are recognized in net earnings during the year.

The Company does not enter into financial instruments for trading or speculative purposes.

p) Revenue

In the United States, revenue from skilled nursing centers is derived from various federal and state medical assistance programs, Managed Care providers (for residents with health maintenance and commercial insurance programs), as well as privately from the residents. Revenue is recorded in the period in which services and products are provided at established rates less contractual adjustments. Contractual adjustments include differences between established billing rates and amounts estimated by management as reimbursable under various reimbursement formulas or contracts in effect. Differences between final settlements and amounts recorded in previous years are reported as adjustments to revenue in the period such settlements are determined.

Extendicare also offers information technology services to smaller long-term care providers through its wholly owned U.S. subsidiary, Virtual Care Provider, Inc. This revenue source is primarily derived from application hosting, customer support, telecommunications, equipment sales and consulting services, and is recognized as these services are provided and equipment is delivered to our customers.

In addition, EHSI derives outpatient therapy revenue in the U.S. by providing rehabilitation therapy services to outside third parties at its clinics. This revenue source is primarily from Managed Care, workers' compensation, self-pay clients and partly from Medicare and Medicaid. Revenue is recognized in the period in which services are provided.

In Canada, fees charged for its nursing centers and home health care services are regulated by provincial authorities, and provincial programs fund a substantial portion of these fees. Revenue is recorded in the period in which services and products are provided.

Assisted living center revenue in the U.S. and Canada is primarily derived from private-pay residents and is recognized in the period in which the services are provided and at rates established by the Company based upon the services provided and market conditions in the area of operation.

Extendicare also offers management, consulting, group purchasing, accounting and administrative services to third parties in both Canada and the United States. Revenue is recorded in the period in which services are provided.

q) Finance Costs and Finance Income

Finance costs include: interest expense on long-term debt; accretion of the discount on provisions, decommissioning provisions and the convertible debentures issued subsequent to the 2012 Conversion *(note 14);* losses on the change in fair value of financial liabilities designated as FVTPL (refer to *note 3(o));* and losses in foreign exchange on non-Canadian based financial assets. Finance income includes interest income on funds invested, gains on the change in fair value of financial liabilities designated as FVTPL, and gains in foreign exchange on non-Canadian based financial assets.

r) Income Taxes

Extendicare and its subsidiaries are subject to income taxes as imposed by the jurisdictions in which they operate, in accordance with the relevant tax laws of such jurisdictions. The provision for income taxes for the period comprises current and deferred income tax.

Current income tax is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the jurisdictions in which we operate. Deferred income tax is calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. With respect to the Company's investment in its foreign subsidiaries, the Company uses the tax rate applicable to dividend distributions, which is based on management's judgement on when the temporary difference will reverse.

The income tax rates used to measure deferred tax assets and liabilities are those rates enacted or substantially enacted at the reporting date, and are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized. For the convertible debentures that are designated as financial liabilities valued at FVTPL *(note 3(o))*, a deferred tax asset is not recorded should the fair value of the convertible debentures be in excess of the principal balance of the convertible debentures.

Current and deferred income tax assets and liabilities are offset when there is a legally enforceable right of offset; and the income taxes are levied by the same taxation authority on either the same taxable entity or different taxable entities, which intend either to settle current tax liabilities and assets on a net basis or to realize the assets and settle the liabilities simultaneously, for each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

In assessing whether the deferred tax assets are realizable, management considers whether it is probable (which the Company has defined as "more likely than not") that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment.

Tax uncertainties are evaluated on the basis of whether it is more likely than not that a tax position will ultimately be sustained upon examination by the relevant taxing authorities. Tax uncertainties are measured using a probability adjusted or expected value model whereby amounts are recorded if there is any uncertainty about a filing position, determined by multiplying the amount of the exposure by the probability that the entity's filing position will not be sustained. The assessment of tax uncertainties relies on estimates and assumptions and may involve a series of judgements about future events. New information may become available that causes the Company to change its judgement regarding the adequacy of existing tax liabilities. Such changes to tax liabilities will impact tax expense in the period that such a determination is made.

s) Discontinued Operations

A discontinued operation is a component of the Company's business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale. Classification as a discontinued operation occurs upon disposal or earlier, if the operation meets the criteria to be classified as held for sale. When an operation is classified as a discontinued operation, the comparative statement of earnings and cash flow information is re-presented as if the operation had been discontinued from the start of the comparative period.

4. NEW ACCOUNTING POLICIES ADOPTED

Effective January 1, 2013, Extendicare adopted three new accounting amendments and standards issued by IASB: IAS 1 "Presentation of Financial Statements", IFRS 13 "Fair Value Measurement", and IFRS 19 "Post-employment Benefits", all of which are discussed below.

Other new accounting amendments and standards effective commencing this year include: IFRS 10 "Consolidated Financial Statements", IFRS 11 "Joint Arrangements and Consolidated Financial Statements", and IFRS 12 "Disclosure of Interests in Other Entities and Consolidated Financial Statements"; adoption of these standards resulted in no impact to Extendicare's financial position, earnings or cash flows.

Presentation of Financial Statements – Other Comprehensive Income

Amendments to IAS 1 "Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income" require entities to group together items within other comprehensive income (OCI) that may be reclassified to the profit or loss section of the statement of earnings and to separately group together items that will not be reclassified to the profit or loss section of the statement of earnings. As these amendments required changes in the presentation of items in OCI, the impact of adoption did not have a material impact on the financial position, earnings or cash flows.

Fair Value Measurement

IFRS 13 "Fair Value Measurement" is a new standard that replaces the fair value measurement guidance contained in individual standards with a single source of fair value measurement guidance. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements to provide information that enables financial statement users to assess the methods and inputs used to develop fair value measurements and, for recurring fair value measurements that use significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or OCI. Upon adoption of this standard, the Company enhanced its disclosure *(note 27(b))* and also changed its fair value basis at which the convertible unsecured subordinated debentures due in 2014 are measured *(note 14);* the impact of the adoption was not significant.

Post-employment Benefits

The amended version of IAS 19 "Employee Benefits" requires: (i) the recognition of actuarial gains and losses immediately in OCI; (ii) the recognition of expected return on plan assets in profit or loss to be calculated based on the rate used to discount the defined benefit obligation; and (iii) the enhancement of disclosure requirements for defined benefit plans, providing better information about the characteristics of defined benefit plans and the risks that entities are exposed to through participation in those plans. There was no material impact on the adoption of these amendments as the Company had already elected to immediately recognize actuarial gains and losses in OCI, and the plan assets are not material.

5. FUTURE CHANGES IN ACCOUNTING POLICIES

The following new standards, amendments to standards and interpretations are effective for annual periods beginning on or after January 1, 2014, and have not been applied in preparing the financial results for the year ended December 31, 2013.

Financial Instruments

IFRS 9 "Financial Instruments", which replaces IAS 39 "Financial Instruments: Recognition and Measurement", addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 replaces the four categories of financial assets as required by IAS 39 with two measurement categories as follows: (i) those measured at fair value; and (ii) those measured at amortized cost. Changes in fair value will be recorded in net earnings under IFRS 9 instead of through OCI under IAS 39. For financial liabilities measured at fair value, fair value changes due to changes in the Company's credit risk are presented in OCI instead of through net earnings unless this would create an accounting mismatch. An accounting mismatch may occur when financial liabilities that are measured at fair value are managed with assets that are measured at fair value through profit or loss. A mismatch could arise because the entire change in the fair value of the financial assets would be presented in net earnings but a portion of the change in the fair value of the related financial liabilities would not. The date of application has not been determined. The Company is assessing the potential impact of this standard.

Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities

Amendments to IAS 32, which establishes disclosure requirements that are intended to help clarify for financial statement users the effect or potential effect of offsetting arrangements on an entity's financial position. These amendments are effective for the annual period beginning on January 1, 2014. The Company is in the process of assessing the impact of the adoption of these amendments, and does not expect that they will have a material impact on its consolidated financial statements.

Levies

IFRS 21 "Levies" clarifies that an entity recognizes the full amount of a liability for a levy during the period in which the activity that triggers payment occurs, as identified by the relevant legislation, instead of amortizing the expense over a period of time. This standard does not apply to income taxes or fines and penalties from governments, and is effective for annual periods beginning on or after January 1, 2014. The Company is in the process of assessing the impact of the adoption of this interpretation on its consolidated financial statements.

6. ACCOUNTS RECEIVABLE

	2013	2012
Trade receivables	**173,472**	165,572
Retroactive rate accruals	**16,308**	25,903
Other receivables	**30,863**	29,438
Total receivables – net of allowance *(note 27(a))*	**220,643**	220,913
Less: non-current portion *(note 11)*	**(9,848)**	(11,395)
Accounts receivable	**210,795**	209,518

7. OTHER CURRENT ASSETS

	2013	2012
Assets held for sale *(note 8)*	**36,418**	3,121
Other	**25,475**	28,287
Other current assets	**61,893**	31,408

8. DISPOSAL GROUP HELD FOR SALE

In December 2013, EHSI decided to sell 11 nursing centers located in various states due to poor operational performance and the need for future capital expenditures. EHSI reclassified the assets and liabilities of these nursing centers to current assets and liabilities. EHSI expects to complete the sale of these centers during the next 12 months. In December 2013, EHSI recorded an impairment charge of $7.3 million (US$6.8 million) to reduce the net book value of the properties to their estimated fair value less costs to sell *(note 20)*.

As at December 31, 2012, disposal group held for sale comprised two closed nursing centers in Washington and Alberta, and two Ontario nursing centers that were closed upon completion of new centers in 2013 *(note 9)*. All three Canadian properties in Alberta and Ontario were sold in 2013 *(note 20)*.

Assets of Disposal Group Held for Sale

	2013	2012
Cash	**189**	–
Restricted cash	**213**	–
Accounts receivable	**7,781**	–
Other current assets	**478**	–
Property and equipment	**27,757**	3,121
Total assets held for sale *(note 7)*	**36,418**	3,121

Liabilities of Disposal Group Held for Sale

	2013	2012
Accounts payable and accrued liabilities	**4,752**	–
Deferred compensation	**2**	–
Decommissioning provisions	**1,242**	512
Long-term debt	**10,360**	–
Total liabilities held for sale *(note 12)*	**16,356**	512

9. PROPERTY AND EQUIPMENT

	Land & Land Improvements	Buildings	Furniture & Equipment	Leasehold Improvements	Construction in Progress	Total
Cost or Deemed Cost						
January 1, 2012	167,136	1,129,429	160,420	8,975	18,770	1,484,730
Additions	2,874	12,128	14,920	493	55,977	86,392
Government grants	–	–	–	–	(3,813)	(3,813)
Interest capitalized	–	–	–	–	873	873
Transfer to assets held for sale	(997)	(11,814)	(379)	–	–	(13,190)
Disposals	–	–	(672)	–	(5)	(677)
Write-off of fully-depreciated assets	(153)	(2,573)	(6,611)	(8)	–	(9,345)
Impairment loss *(note 20)*	–	(17,796)	–	–	–	(17,796)
Reversal of impairment loss *(note 20)*	73	15,996	–	–	–	16,069
Transfer from construction-in-progress	1	6,537	1,594	(167)	(7,965)	–
Reclass and other	(2)	(813)	1	–	(1,054)	(1,868)
Effect of movements in exchange rates	(2,898)	(16,480)	(2,460)	(133)	(95)	(22,066)
December 31, 2012	166,034	1,114,614	166,813	9,160	62,688	1,519,309
Additions	**572**	**7,194**	**12,680**	**523**	**34,421**	**55,390**
Government grants	–	**(37,007)**	–	–	–	**(37,007)**
Interest capitalized	–	–	–	–	**1,232**	**1,232**
Transfer to assets held for sale	**(7,054)**	**(24,743)**	**(9,091)**	**(228)**	**(29)**	**(41,145)**
Disposals	–	–	**(42)**	–	–	**(42)**
Write-off of fully-depreciated assets	**(22)**	**(3,175)**	**(4,130)**	**(36)**	–	**(7,363)**
Impairment loss *(notes 10 and 20)*	**(1,476)**	**(2,659)**	**(165)**	–	–	**(4,300)**
Transfer from construction-in-progress	**2,205**	**82,325**	**8,131**	**(849)**	**(91,812)**	–
Reclass and other	**68**	**(375)**	**(222)**	**(1,291)**	**(204)**	**(2,024)**
Effect of movements in exchange rates	**9,163**	**52,767**	**8,438**	**442**	**218**	**71,028**
December 31, 2013	**169,490**	**1,188,941**	**182,412**	**7,721**	**6,514**	**1,555,078**
Accumulated Depreciation						
January 1, 2012	12,703	190,242	84,185	4,687	–	291,817
Additions	5,893	46,031	17,143	987	–	70,054
Transfer to assets held for sale	(103)	(10,058)	(253)	–	–	(10,414)
Disposals	–	–	(529)	–	–	(529)
Write-off of fully-depreciated assets	(153)	(2,573)	(6,611)	(8)	–	(9,345)
Reclass and other	(1)	(345)	6	(148)	–	(488)
Effect of movements in exchange rates	(260)	(1,676)	(1,371)	(75)	–	(3,382)
December 31, 2012	18,079	221,621	92,570	5,443	–	337,713
Additions	**6,187**	**48,382**	**17,683**	**756**	–	**73,008**
Transfer to assets held for sale	**(1,028)**	**(5,549)**	**(6,998)**	**(20)**	–	**(13,595)**
Disposals	–	–	**(42)**	–	–	**(42)**
Write-off of fully-depreciated assets	**(22)**	**(3,175)**	**(4,130)**	**(36)**	–	**(7,363)**
Reclass and other	**69**	**(83)**	**(157)**	**(1,419)**	–	**(1,590)**
Effect of movements in exchange rates	**1,292**	**8,248**	**5,121**	**279**	–	**14,940**
December 31, 2013	**24,577**	**269,444**	**104,047**	**5,003**	–	**403,071**
Carrying amounts						
At December 31, 2012	147,955	892,993	74,243	3,717	62,688	1,181,596
At December 31, 2013	**144,913**	**919,497**	**78,365**	**2,718**	**6,514**	**1,152,007**

The cost of assets included in property and equipment under finance leases was $88.5 million (December 31, 2012 – $87.0 million) with accumulated depreciation of $25.0 million (December 31, 2012 – $22.2 million) *(note 14)*.

ECI completed the construction of two Ontario redevelopment projects during 2013: a new 256-bed nursing center in Sault Ste. Marie was completed in March 2013 and opened to residents in April 2013; another new 180-bed nursing center in Timmins was completed and opened to residents in October 2013. The construction costs of these projects amounted to approximately $80 million and these new centers replaced two owned centers (287 class "C" beds) and one leased center (95 interim beds) in the communities.

Upon the opening of each of these nursing centers, ECI is entitled to receive capital funding from the Government of Ontario, subject to ECI operating the centers as prescribed under the guidelines of the Ministry of Health and Long-Term Care (Ontario), as part of the program to redevelop existing class "C" beds in Ontario. The funding provides for a payment of $14.30 per bed per day upon the opening of each center, and continues for a period of 25 years. This funding has been discounted at the applicable Ontario government bond rates, and the present value is recorded as a note receivable within other assets, with an offset to the cost of buildings upon inception; as this funding is received over time, the accretion of the note receivable is recognized in interest revenue as part of net finance costs within net earnings.

In May 2012, EHSI entered into an agreement to lease all 21 of its Kentucky skilled nursing centers (1,762 beds) to an experienced third-party long-term care operator based in Texas that operates, through its affiliates, in a number of other states. Nineteen of the centers (1,545 beds) were leased effective July 1, 2012, and the remaining two centers (217 beds) were leased effective October 1, 2012. Under the agreement, the operating leases have 10-year terms with two five-year extensions at the option of the operator. The aggregate annual lease revenue for the first four years is US$15.0 million with a minimum rent escalation of 2.5% in year five, and 3% per year thereafter, depending on whether the operator elects to acquire the centers at the specified period defined in the lease. If certain conditions are met, the operator has the option to purchase all of the centers during the initial lease term at agreed-upon per bed amounts. A pre-tax loss of $3.6 million (US$3.6 million) was recorded in 2012 relating to this Kentucky transaction *(note 20)*.

Between 2008 and 2011, forgivable loans were granted by several regional Health Authorities in the Province of Alberta for a portion of construction costs of a nursing and an assisted living center in Red Deer, a designated assisted living center in Lethbridge and a nursing center in Edmonton. In 2011, forgivable loans were granted from a municipality in the Province of Ontario for a nursing center in Timmins. As at December 31, 2012, all forgivable loans in respect of these projects had been received. The forgivable government loans received were accounted for as government grants as the likelihood of triggering repayment is remote. All grants were netted with other costs and included in construction-in-progress until the development was completed and were netted with the cost of the building upon completion.

Interest is capitalized in connection with the construction of centers and is amortized over their estimated useful life at 5.86% for 2013 and 2012. Interest capitalized in 2013 was $1.2 million (2012 – $0.9 million).

10. GOODWILL AND OTHER INTANGIBLE ASSETS

	2013	2012
Goodwill		
Balance at beginning of year	**70,503**	73,323
Disposals	**–**	(418)
Impairment loss	**(3,775)**	(1,080)
Effect of movements in exchange rates	**3,912**	(1,322)
Balance at end of year	**70,640**	70,503
Other Intangible Assets		
Gross carrying value at beginning of year	**40,991**	36,547
Additions	**362**	4,365
Write-off of fully amortized assets	**(120)**	(168)
Other	**157**	930
Effect of movements in exchange rates	**2,506**	(683)
Gross carrying value at end of year	**43,896**	40,991
Accumulated amortization at beginning of year	**(28,701)**	(22,601)
Amortization	**(4,921)**	(6,751)
Write-off of fully amortized assets	**120**	168
Other	**146**	(7)
Effect of movements in exchange rates	**(1,951)**	490
Accumulated amortization at end of year	**(35,307)**	(28,701)
Net carrying value	**8,589**	12,290
Goodwill and other intangible assets	**79,229**	82,793

Goodwill

The carrying value of goodwill is reviewed at each reporting date to determine whether there exists any indication of impairment. If any indication exists, then the assets' recoverable amount is estimated and an impairment loss is recognized if the carrying amount of the asset or its related CGU exceeds the estimated recoverable amount *(note 20)*.

In 2013, EHSI recognized a net pre-tax recovery of $0.1 million (US$0.1 million), consisting of a goodwill impairment of $3.7 million (US$3.6 million), an $11.9 million (US$11.5 million) impairment on certain properties and a $15.7 million (US$15.2 million) reversal of a previously recorded impairment loss on property and equipment. An additional impairment was recognized in December 2013, but it did not affect goodwill *(note 20)*.

In January 2012, EHSI completed the sale of its group purchasing organization (GPO), resulting in a reduction in goodwill of $0.4 million or US$0.4 million *(note 23)*.

In 2012, EHSI recognized a net pre-tax impairment loss of $0.2 million (US$0.2 million), consisting of a goodwill impairment of $1.1 million (US$1.1 million), a $15.2 million (US$15.5 million) impairment on certain properties and a $16.1 million (US$16.4 million) reversal of a previously recorded impairment loss on property and equipment *(note 20)*.

Other Intangible Assets

Other intangible assets comprise computer software, purchased licenses and non-compete agreements. Computer software represents the majority of other intangible assets with a gross and net carrying value of $39.0 million and $4.8 million, respectively (December 31, 2012 – $36.6 million and $8.4 million).

11. OTHER ASSETS

	2013	2012
Investments held for self-insured liabilities: available-for-sale securities, at fair value	**118,827**	115,025
Notes, mortgages and amounts receivable	**84,896**	50,037
Medicare and Medicaid settlement receivables, less allowance of nil *(note 6)*	**9,848**	11,395
	213,571	176,457

Investments Held for Self-insured Liabilities

Extendicare holds investments within its Bermuda-based captive insurance company for self-insured liabilities that are subject to insurance regulatory requirements and are categorized as held to maturity or available for sale. The investment portfolio comprises U.S. dollar-denominated cash, money market funds and investment-grade corporate and government securities. Certain of these investments in the amount of $19.4 million (US$18.2 million), (December 31, 2012 – $18.9 million, or US$19.0 million), have been pledged as collateral for letters of credit issued by the banker of the Company's captive insurance company in favour of ceding companies. As at December 31, 2013, all investments were categorized as available for sale.

	2013	2012
Fixed income securities, with maturities due:		
In one year or less	**1,214**	6,194
After 1 year through 5 years	–	11,010
	1,214	17,204
Cash and money market funds	**94,717**	88,366
Equities	**22,896**	9,455
	118,827	115,025

Financial assets include the following available-for-sale securities:

	2013	2012
U.S. Treasuries	**1,214**	17,204
Equities	**22,896**	9,455
	24,110	26,659

Notes, Mortgages and Amounts Receivable

Included in notes, mortgages and amounts receivable were $66.8 million (December 31, 2012 – $34.3 million) of discounted amounts receivable due from government agencies. These represented amounts funded by the Ontario government for a portion of nursing center construction costs. As each center was opened, a receivable from the government was recorded based on applying a discount rate equivalent to the yield on an Ontario government bond for an equivalent duration. The two new Ontario centers qualify for construction funding of $14.30 per bed per day over 25 years *(note 9)*, and all existing centers are funded at $13.30 per bed per day over 20 years. The amounts were discounted at rates ranging from 3.6% to 6.5%, and were treated as a reduction in the cost of the property and equipment related to the center.

Medicare and Medicaid Settlement Receivables

Settlement receivables from both Medicare and Medicaid state programs at December 31, 2013, totalled $13.3 million (December 31, 2012 – $23.7 million), with no allowance. EHSI's Medicare settlement receivables primarily relate to reimbursable Part A co-insurance receivables. Medicaid settlement receivables pertain to cost-based reimbursement programs. Differences between the final settlement and amounts previously recorded are reported as adjustments to revenue in the period of determination. The amounts expected to be substantially collected within one year are reported as current accounts receivable, and the remaining amounts totalling $9.8 million (December 31, 2012 – $11.4 million) were reported in other assets.

12. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2013	2012
Accounts payable	**31,030**	35,508
Accrued liabilities	**198,359**	202,401
Liabilities held for sale *(note 8)*	**16,356**	512
Total	**245,745**	238,421

13. PROVISIONS

	Accrual for Self-insured Liabilities	Decommissioning Provisions	Total
January 1, 2012	79,423	26,105	105,528
Provisions recorded	40,807	–	40,807
Provisions used	(23,933)	(17)	(23,950)
Reclass	1,019	(517)	502
Accretion	427	1,694	2,121
Effect of movements in exchange rates	(1,813)	(414)	(2,227)
December 31, 2012	95,930	26,851	122,781
Less: current portion	21,888	–	21,888
	74,042	26,851	100,893
January 1, 2013	**95,930**	**26,851**	**122,781**
Provisions recorded	**54,482**	–	**54,482**
Provisions used	**(42,720)**	–	**(42,720)**
Reclass	**(294)**	**(1,281)**	**(1,575)**
Accretion	**883**	**1,823**	**2,706**
Effect of movements in exchange rates	**7,028**	**1,408**	**8,436**
December 31, 2013	**115,309**	**28,801**	**144,110**
Less: current portion	**28,052**	–	**28,052**
	87,257	**28,801**	**116,058**

Accrual for Self-insured Liabilities

Within the long-term care industry, operators including the Company are subject to lawsuits alleging negligence, malpractice, or other related claims. The Company maintains liability insurance policies through third-party insurers as well as retaining a portion of the risk within its Bermuda-based captive insurance company at a level that the Company believes to be adequate based upon the nature and risks of its business, historical experience and industry standards, along with the type of insurance coverage commercially available in the marketplace.

The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. The Company estimates the value of losses that may occur within its self-insured retention levels, based upon individual assessment of the settlement, using historical information and industry data, supported by actuarial projections, advice from legal counsel, consultants and external risk management. General and professional liability claims are the most volatile and significant type of risks for which the Company self-insures, furthermore, claim payments for any particular policy year can occur over a period of several years that are limited by state or provincial regulations. Actual results can differ materially from the estimates made due to a number of factors including the assumptions used by management and other market forces.

Management regularly evaluates and periodically engages an independent third-party actuary to provide a report to determine the appropriateness of the carrying value of this liability. Assumptions underlying the determination of the liability are limited by the uncertainty of predicting future events and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; trends in claims along with unique and identifiable settlements; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation. Therefore, management's estimate of the accrual for general and professional liability claims is significantly influenced by assumptions that are subject to judgement by management and the actuary, which may cause the provision to fluctuate significantly from one reporting period to another.

Management estimates and allocates a portion of the general and professional liability claim payments as current on the statement of financial position.

Decommissioning Provisions

The decommissioning provisions relate to possible asbestos remediation of Extendicare's pre-1980 constructed centers *(note 3(m))*.

14. LONG-TERM DEBT

	Interest rate	Year of Maturity		**2013**	2012
			US$	C$	C$
EHSI *(payable in US$)*					
HUD mortgages	3.20% – 5.75%	2022 – 2047	*542,229*	**576,715**	521,576
Line of credit	variable	2015	*2,100*	**2,234**	8,059
PrivateBank loans	variable	2013	–	–	33,774
Finance lease obligations	0% – 6.56%	2014 – 2016	*2,132*	**2,267**	2,640
Notes payable	0%	2014	*68*	**72**	4,048
			546,529	**581,288**	570,097
Financing costs			*(17,860)*	**(18,995)**	(19,234)
			528,669	**562,293**	550,863
Extendicare Inc. and Canadian Subsidiaries *(payable in C$)*					
Convertible unsecured subordinated debentures	6.0%	2019		**121,590**	120,915
Convertible unsecured subordinated debentures	5.7%	2014		**114,226**	117,325
CMHC mortgages	2.22% – 7.7%	2014 – 2037		**175,762**	189,209
Non-CMHC mortgages	4.14% – 5.637%	2020 – 2038		**95,688**	15,533
Finance lease obligations	6.41% – 7.19%	2026 – 2028		**105,711**	110,343
Construction loans	5.558% – 5.637%	2038		–	39,652
				612,977	592,977
Financing costs				**(10,434)**	(11,605)
				602,543	581,372
Total debt net of financing costs				**1,164,836**	1,132,235
Less: current portion				**148,051**	93,448
				1,016,785	1,038,787

EHSI Debt

REFINANCINGS

During 2012, EHSI completed the refinancing of approximately US$636 million of debt with approximately US$506 million of mortgages insured by the U.S. Department of Housing and Urban Development (HUD) and US$130 million of cash on hand. During 2011 and 2012, EHSI closed on 68 HUD loans totalling US$506.3 million in connection with this refinancing, with a weighted average interest rate of approximately 4.33%, inclusive of mortgage insurance premiums (MIP), and term to maturity of about 33 years.

In July 2010, EHSI received approval as a corporate entity to proceed with HUD applications, subject to an overall limit of US$550.0 million, and in December 2011, received approval to increase the financing capacity to an overall limit of US$585.0 million, which expires in September 2014. EHSI already had approximately US$27 million of HUD loans issued prior to this refinancing plan. In April 2013, EHSI closed on six HUD loans totalling US$37.7 million to refinance the PrivateBank loans. These HUD loans have a weighted average interest rate of 3.66% (including MIP of 0.65%) and term to maturity of approximately 32 years. Consequently, EHSI utilized approximately US$572 million of its US$585.0 million overall limit. As at December 31, 2013, EHSI had approximately 57 unencumbered centers, which includes 19 centers that are leased to a third-party operator in Kentucky.

In July 2012, EHSI prepaid US$10.3 million of HUD-insured mortgages with a weighted average interest rate including MIP of 5.77% and closed on new HUD-insured mortgages totalling US$11.2 million with a weighted average interest rate including MIP of 3.55%. EHSI recorded a $0.8 million (US$0.8 million) loss on refinancing and retirement of debt associated with this refinancing *(note 20).*

HUD MORTGAGES

As at December 31, 2013, EHSI has a total of 82 HUD-insured mortgages, which are secured by 82 skilled nursing centers and two assisted living facilities, of which two centers with HUD mortgages totalling US$10.1 million were classified as liabilities held for sale *(note 8).* These mortgages have an average remaining term of 30 years with fixed interest rates ranging from 3.20% to 5.75% and a weighted average interest rate of 4.30%. Depending on the mortgage agreement, prepayments are generally allowed, with HUD approval, only after 12 months or 24 months from the inception of the mortgage, and in the first year thereafter, prepayments are subject to penalties between 8% and 10% of the remaining principal balances. The prepayment penalties decrease each subsequent year by 1% until no penalty is required. As at December 31, 2013, US$179.0 million of the mortgages could not be prepaid, US$369.1 million were subject to prepayment fees between 8% and 10%, and US$4.2 million were subject to prepayment fees of 2%.

All HUD-insured mortgages are non-recourse loans to EHSI. All mortgages are subject to HUD regulatory agreements that require escrow reserve funds to be deposited with the loan servicer for MIP, property taxes, insurance and for capital replacement expenditures. As at December 31, 2013, EHSI had escrow reserve funds of $6.3 million (US$5.9 million) with the loan servicers that are reported within other current assets, and replacement reserve funds of $11.5 million (US$10.8 million) in other non-current assets. In addition, cash for working capital purposes may only be distributed semi-annually to EHSI from the real estate special purpose entities within the HUD mortgage structures. As at December 31, 2013, restricted cash for working capital was $16.6 million (US$15.7 million), $0.2 million (US$0.2 million) of which was included in assets held for sale *(note 8).*

CMBS FINANCING

EHSI's commercial mortgage backed securitization (CMBS) financing due in May 2012 (the "May 2012 CMBS Financing"), was completed on October 16, 2006, for US$500.0 million through commercial mortgage backed securities. The original maturity date was November 11, 2011, but this date was extended to May 11, 2012, under the Loan Modification Agreement described below. It had a fixed interest rate of 6.6525%, with interest-only monthly payments for the first three years, and monthly principal and interest payments thereafter, based upon a 25-year amortization.

In May 2011, EHSI signed an agreement to modify its May 2012 CMBS Financing (the "Loan Modification Agreement") for a fee of US$5.4 million. The Loan Modification Agreement extended the maturity date from November 2011 to May 2012 and, during the period between August 2011 and May 2012, allowed EHSI to prepay in part and release properties from this loan without any prepayment yield maintenance payment. The Loan Modification Agreement enhanced the ability to complete the closing of the HUD mortgages in stages.

In August and October 2011, we prepaid US$194.9 million and US$172.4 million, respectively, of the May 2012 CMBS Financing. In February 2012, we prepaid the final US$109.9 million of May 2012 CMBS Financing *(note 20).*

CREDIT FACILITY

In 2012, EHSI entered into a new US$100.0 million senior secured revolving credit facility (the "EHSI Credit Facility") with a three-year term to June 2015 and floating-rate interest based on a pricing grid, to replace its US$70.0 million credit facility that matured in June 2012. This new credit facility consists of a US$80.0 million real estate based facility that was finalized in June 2012, and a US$20.0 million accounts receivable based credit facility that was finalized in September 2012. At EHSI's option, the interest rate is either the eurodollar rate, with a floor set at 1%, plus a margin from 4% to 4.50%, or the U.S. prime rate plus a margin from 3% to 3.50%, with the specific margin based on EHSI's consolidated leverage ratio as defined in the EHSI Credit Facility.

The EHSI Credit Facility is used to back letters of credit and for general corporate purposes, and requires EHSI to comply with various financial covenants, including fixed charge coverage, debt leverage and tangible net worth ratios. It contains customary covenants and events of default and is subject to various mandatory prepayment and commitment reductions. If an event of default occurs, the lenders may accelerate the maturity of the loan under the EHSI Credit Facility, charge a default rate of interest, and/or foreclose on the mortgages and other collateral securing the EHSI Credit Facility. EHSI is permitted to make voluntary prepayments at any time.

The maximum amount available to be borrowed under the US$80.0 million portion of the EHSI Credit Facility is determined based on the lesser of: (i) 50% of the appraised values of the 20 skilled nursing centers collateralizing the EHSI Credit Facility, or (ii) an amount based on the actual net cash flow of these centers for the last 12 months. This US$80.0 million real estate based facility is secured by mortgages on 20 skilled nursing centers and is guaranteed by EHSI's parent, Extendicare Holdings, Inc., and certain of EHSI's domestic subsidiaries. EHSI's entities that are HUD borrowers or HUD operators are classified as specified non-recourse subsidiaries and unrestricted subsidiaries under the EHSI Credit Facility; however, the entities are considered restricted subsidiaries solely with respect to certain financial covenants. As at December 31, 2013, the maximum amount available was US$66.4 million.

The maximum amount available to be borrowed under the US$20.0 million portion of the EHSI Credit Facility is based upon 80% of eligible receivables that are less than 90 days old. As at December 31, 2013, the maximum amount available was US$20.0 million.

In total, the maximum amount available to be borrowed as at December 31, 2013, was US$86.4 million, of which EHSI had drawn US$2.1 million, and issued US$8.3 million under letters of credit, leaving US$76.0 million of the maximum available for future working capital and corporate purposes, subject to leverage requirements. The letters of credit of US$8.3 million are in favour of workers' compensation programs, which renew annually and mature in June and July of 2014.

PRIVATEBANK LOANS

As mentioned above, in April 2013, EHSI closed on six HUD loans totalling US$37.7 million, at which time, the PrivateBank loans with an aggregate balance of US$33.8 million were repaid in full, resulting in a loss of US$0.4 million *(note 20).*

NOTES PAYABLE

In November 2013, the final instalment of US$4.0 million was paid on notes payable which related to seller notes arising from the 2007 acquisition of Tendercare (Michigan) Inc. (Tendercare) *(note 20).*

FINANCE LEASE OBLIGATIONS

In November 2010, EHSI entered into a 10-year finance lease for a 100-bed skilled nursing center in South Bend, Indiana. In December 2012, EHSI exercised its option under the agreement and purchased this center for US$13.2 million in cash, consisting of the US$12.5 million in repayment of the finance lease obligation and a US$0.7 million purchase of additional property and equipment.

Finance lease obligations are payable as follows:

	2013			2012		
	Future Minimum Lease Payments	**Interest**	**Present Value of Minimum Lease Payments**	Future Minimum Lease Payments	Interest	Present Value of Minimum Lease Payments
Less than one year	**1,626**	**75**	**1,551**	808	124	684
Between one and five years	**736**	**20**	**716**	2,081	125	1,956
	2,362	**95**	**2,267**	2,889	249	2,640

Canadian Debt

CONVERTIBLE UNSECURED SUBORDINATED DEBENTURES

In 2012, Extendicare issued $126.5 million of aggregate principal amount of 6.00% convertible unsecured subordinated debentures due September 30, 2019, convertible at $11.25 per Common Share (the "2019 Debentures"). The initial offering of $110.0 million closed on September 25, 2012, for net proceeds of $104.8 million; and the exercise of the over-allotment option for $16.5 million closed on October 1, 2012, for additional net proceeds of $15.9 million, securing total net proceeds of $120.7 million on this offering.

Interest on the 2019 Debentures is payable semi-annually in March and September. The 2019 Debentures may not be redeemed by the Company prior to October 1, 2015, except in the event of the satisfaction of certain conditions after a change of control has occurred. On or after October 1, 2015, but prior to October 1, 2017, these debentures may be redeemed by the Company in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, on a notice of not more than 60 days and not less than 30 days prior, provided that the volume-weighted average trading price of the Common Shares on the TSX for the 20 consecutive trading days ending on the fifth trading day immediately preceding the date on which notice of redemption is given is not less than 125% of the conversion price. On and after October 1, 2017, these debentures may be redeemed by the Company in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, on a notice of not more than 60 days and not less than 30 days prior.

Upon the occurrence of a change of control, whereby more than 66.67% of the Common Shares are acquired by any person, or group of persons acting jointly, each holder of the 2019 Debentures may require the Company to purchase their debentures at 101% of the principal. If 90% or more of the debentureholders do so, the Company has the right, but not the obligation, to redeem all the remaining outstanding 2019 Debentures.

Upon closing of the initial offering on September 25, 2012, the debt and equity components of the 2019 Debentures were bifurcated as the financial instrument is considered a compound instrument with $105.0 million classified as a liability and the residual $5.0 million classified as equity attributable to the conversion option. Following the completion of the exercise of the over-allotment option on October 1, 2012, the bifurcation of the 2019 Debentures resulted in $120.7 million classified as a liability and the residual $5.8 million classified as equity. The liability portion of the 2019 Debentures is recorded at amortized cost. The fees and transaction costs allocated to the debt component are amortized over the term of the 2019 Debentures using the effective interest method and recognized as part of net finance costs.

Extendicare completed a public offering of convertible unsecured subordinated debentures in June 2008 (the "2013 Debentures") and June 2007 (the "2014 Debentures"), (collectively the "REIT Issued Convertible Debentures"). On October 29, 2012, Extendicare redeemed the outstanding aggregate principal amount of the 2013 Debentures of $91.8 million, and paid all accrued and unpaid interest thereof for a total payment of $94.0 million *(note 20)*. With respect to the 2014 Debentures, the aggregate principal balance outstanding at December 31, 2013, was $113.9 million and is due on June 30, 2014. The 2014 Debentures have a $19.90 conversion price, and a 5.7% coupon rate with interest payable semi-annually in June and December. These were designated as financial liabilities valued at fair value, with changes in fair value recognized in net earnings as part of net finance costs. Fair value is based on the closing price of the publicly traded convertible debentures on each reporting date. Other than the relevant redemption dates, the redemption features, terms and conditions are identical to the 2019 Debentures described above. As of July 1, 2012, the 2014 Debentures may be redeemed by the Company in whole at any time or in part from time to time at a price equal to the principal amount thereof plus accrued interest, on a notice of not more than 60 days and not less than 30 days prior.

CMHC MORTGAGES

Extendicare's Canadian subsidiaries have various mortgages insured through the Canada Mortgage and Housing Corporation (CMHC) program. The CMHC Mortgages are secured by several Canadian financial institutions at rates ranging from 2.22% to 7.7% with maturity dates through to 2037.

Effective August 1, 2013, ECI renewed its existing CMHC mortgage on three Ontario nursing centers for a term of five years at a fixed rate of 3.08%. This mortgage was renewed at its maturing balance of $15.4 million.

In January 2014, ECI committed to the renewal of its existing $6.4 million CMHC mortgage on an Ontario nursing center for a 10-year term at a fixed rate of 3.62%, effective March 1, 2014.

NON-CMHC MORTGAGES

ECI has completed the refinancing of three Manitoba nursing centers in September 2013, with conventional mortgages totalling $26.0 million at a fixed rate of 4.14% for a term of seven years. The existing mortgages had a balance of $15.3 million at June 30, 2013, maturing in November 2013. Two Ontario nursing centers were opened in April and October of 2013, following which their construction loans totalling $69.9 million were converted to conventional mortgages *(see "construction loans" below).*

FINANCE LEASE OBLIGATIONS

ECI obtained financing of $125.4 million in 2001 from BCP Long-Term Care Facilities Inc. (BCP) to build eight Ontario nursing centers and entered into another arrangement in 2003 with BCP for $14.4 million of financing for an additional Ontario nursing home. ECI is operating the centers for BCP under 25-year finance lease arrangements at an average effective rate of 6.99%.

Finance lease obligations are payable as follows:

	2013			2012		
	Future Minimum Lease Payments	**Interest**	**Present Value of Minimum Lease Payments**	Future Minimum Lease Payments	Interest	Present Value of Minimum Lease Payments
Less than one year	**12,104**	**7,141**	**4,963**	12,104	7,472	4,632
Between one and five years	**48,416**	**24,767**	**23,649**	48,416	26,341	22,075
More than five years	**104,404**	**27,305**	**77,099**	116,508	32,872	83,636
	164,924	**59,213**	**105,711**	177,028	66,685	110,343

CONSTRUCTION LOANS

In October 2011, ECI secured conventional long-term financing on its Timmins and Sault Ste. Marie centers in Ontario. The first two years of the loans are for construction with interest-only payments, following which the loans will be amortized over 25 years. The Timmins and Sault Ste. Marie loans contain fixed rates for the full 27-year term of 5.558% and 5.637%, respectively, with a requirement to maintain a minimum debt service coverage ratio. The Sault Ste. Marie center and the Timmins center opened in April and October of this year *(note 9);* consequently, the corresponding loans were converted to conventional mortgages in the third and fourth quarters of 2013, respectively.

Other

RBC LINE OF CREDIT AND LETTERS OF CREDIT

Extendicare has a demand credit facility with the Royal Bank of Canada (the "RBC Credit Facility") that, as at December 31, 2013, was secured by 13 class "C" nursing centers in Ontario and is guaranteed by certain Canadian subsidiaries of Extendicare. During 2013, the demand working capital line was reduced to $64.0 million from $70.0 million following the completion of two new nursing centers in northern Ontario, which resulted in the transfer of licensed beds from nursing centers that secured the line.

As at December 31, 2013, Extendicare had letters of credit totalling $42.3 million issued under the working capital line, of which $42.0 million was issued to secure executive pension obligations, and $0.3 million related to construction projects. The RBC Credit Facility has no financial covenants, but does contain normal and customary terms, including the periodic re-appraisal of the centers that could limit the maximum amount available under the working capital line.

RESTRICTED CASH

Restricted cash consists mainly of $16.4 million (US$15.5 million) held pursuant to the HUD regulatory agreements for working capital purposes, and cash designated for future capital expenditure in Indiana.

UNDRAWN BORROWING FACILITIES

The Company has the following undrawn borrowing facilities:

	2013	2012
Variable Rate		
Expiring within one year	**21,679**	26,864
Expiring beyond one year	**80,834**	88,845
Total	**102,513**	115,709

FINANCING COSTS

Financing costs are deducted from long-term debt and are amortized using the effective interest method over the term of the debt. Financing costs included as part of long-term debt amounted to $29.4 million at December 31, 2013 (2012 – $30.8 million). The decrease of $1.4 million in 2013 related primarily to the addition of $1.5 million of costs associated with amortization charges included in finance costs, partially offset by financing of new and refinancing of existing debt and changes in foreign exchange.

Below is a summary of the financing costs:

		2013		2012
	US$	C$	*US$*	C$
EHSI *(payable in US$)*				
HUD mortgages	*16,222*	**17,253**	*16,611*	16,528
Line of credit	*1,638*	**1,742**	*2,541*	2,528
PrivateBank loans	–	–	*179*	178
	17,860	**18,995**	*19,331*	19,234
Extendicare Inc. and Canadian Subsidiaries *(payable in C$)*				
Convertible unsecured subordinated debentures		**4,525**		5,284
CMHC mortgages		**4,455**		5,161
Non-CMHC mortgages		**1,065**		54
Finance lease obligations		**389**		429
Construction loans		–		677
		10,434		11,605
Total financing costs		**29,429**		30,839
Less: current portion		**3,519**		3,027
		25,910		27,812

PRINCIPAL REPAYMENTS

Principal repayments on long-term debt, exclusive of finance lease obligations and liabilities held for sale, are as follows:

Year	Amount
2014	144,761
2015	27,352
2016	32,000
2017	43,202
2018	30,433
2019 and beyond	813,153
	1,090,901

INTEREST RATES

The weighted average interest rate of all long-term debt at December 31, 2013, was approximately 4.9% (2012 – 5.0%). At December 31, 2013, 99.8% of the long-term debt, excluding financing costs, was at fixed rates.

15. OTHER LONG-TERM LIABILITIES

	2013	2012
Accrued pension plan obligation *(note 26)*	**32,989**	33,619
Deferred compensation	**10,839**	11,322
Share appreciation rights	**183**	217
Future lease commitments	**1,683**	1,680
Other	**453**	1,187
	46,147	48,025

Deferred Compensation

EHSI maintains an unfunded deferred compensation plan offered to all corporate employees defined as highly compensated by the U.S. Internal Revenue Code in which participants may defer up to 10% of their base salary. EHSI will match up to 50% of the amount deferred. EHSI also maintains non-qualified deferred compensation plans covering certain executive employees.

Share Appreciation Rights Plan

Upon completion of the 2012 Conversion, the unit appreciation rights plan (the “UARP”) and all outstanding unit appreciation rights under the UARP, were amended to replace references to the REIT and the REIT Units to Extendicare Inc. and Common Shares, respectively. SARs are granted at the discretion of the Board. Any director, officer or employee of Extendicare or its affiliates is eligible to participate.

A summary of the SARs that have been granted to date by the Board to senior management and the directors as at December 31st is as follows:

	2013		2012	
	Share Appreciation Rights	**Weighted Average Vesting Price**	Share Appreciation Rights	Weighted Average Vesting Price
Outstanding, beginning of year	**1,616,750**	**$9.66**	1,462,417	$9.49
Granted	**474,000**	**6.52**	614,000	8.11
Vested	**(488,750)**	**10.02**	(389,667)	6.64
Forfeited	**(129,501)**	**9.09**	(70,000)	9.47
Outstanding, end of year	**1,472,499**	**$8.58**	1,616,750	$9.66

The fair value of SARs was measured based on the Black-Scholes model. The inputs used in the fair value measurement for 2013 and 2012 were as follows:

	2013	2012
Share price	**$6.58**	$7.68
Volatility	**21.00%**	20.00%
Risk-free interest rate	**0.91% – 1.17%**	0.92% – 1.14%
Strike price	**$6.52 – $11.16**	$7.58 – $11.16
Expected remaining life	**0.2 years – 2.6 years**	0.2 years – 2.2 years

The vesting price represents the price at which the respective SARs were granted, and equates to the minimum Common Share price at which they can be vested. As at December 31, 2013, 1,472,499 SARs were outstanding, with an average remaining contractual life of 1.3 years (December 31, 2012 – 1.3 years). There was a nominal recovery in 2013 (2012 – $0.3 million was expensed in net earnings as an increase to the obligation in SARs). The total liability was $0.2 million included in other long-term liabilities as at December 31, 2013 and 2012.

Awards under the SARP cliff vest after three years, subject to conditions as described below, and permit the participants to receive, at the election of the Board, either a payment in cash or equivalent value of Common Shares acquired on the TSX. Vesting of SARs is subject to continued employment of the participant, with pro-rating provisions in the event of the participant's death, retirement or termination of employment as described below, a minimum Common Share price, and may also be subject to achieving operating performance measures, as determined by the Board at the date of grant. Consideration for vested SARs is equal to the appreciation in the Fair Market Value of the vested SARs from the date of grant of the SAR, plus Accrued Distributions.

The SARP contains provisions providing for adjustments in the event of a corporate reorganization, including an amalgamation or merger of the Company with or into another entity, or in the event of a change in control (as defined in the SARP). Upon termination of employment (for cause) of a participant, all of his or her SARs (vested and unvested) shall be cancelled and terminated without payment. In the event of the death, retirement, or termination of employment (other than for cause) of a participant, that occurs on or after the first anniversary date of the date of grant of a particular SAR, the number of SARs available to vest for the remaining term of such grant is pro-rated based on the elapsed time since the date of grant. The balance of the number of SARs under such grant shall be cancelled and terminated without payment. If the date of any such event occurs prior to the first anniversary date of the date of grant of a particular SAR, then such SAR is cancelled and terminated without payment.

Future Lease Commitments

The effects of scheduled rent increases included in minimum lease payments are recognized on a straight-line basis over the lease term. The amount recorded as future lease commitments represents the cumulative excess of lease expense computed on a straight-line basis for the lease term over actual lease payments.

16. SHARE CAPITAL

2012 Conversion

At a special meeting held on May 8, 2012, Extendicare REIT received 97.72% approval from holders of REIT Units (the "Unitholders") of the plan to convert from an income trust structure to a corporate structure. The 2012 Conversion received all of the necessary third-party and regulatory approvals, including the approval of the TSX, and was completed effective July 1, 2012.

Under the 2012 Conversion, Unitholders had their REIT Units exchanged for Common Shares of Extendicare on the basis of one Common Share for each REIT Unit held. In addition, Extendicare assumed all of the obligations of the REIT in respect of its outstanding REIT Issued Convertible Debentures, of which the 2014 Debentures remain outstanding. As a result, holders of the REIT Issued Convertible Debentures are entitled to receive Common Shares on the same basis that REIT Units were previously issuable on the conversion thereof. The Common Shares commenced trading on the TSX on July 5, 2012, under the trading symbol "EXE" and the REIT Units were de-listed concurrently. The 2013 Debentures and the 2014 Debentures continued trading on the TSX under the trading symbols "EXE.DB" and "EXE.DB.A", respectively.

There were no changes resulting from the 2012 Conversion to the members of the Board or senior management of Extendicare.

Authorized Capital

Extendicare is authorized to issue an unlimited number of Common Shares and that number of preferred shares of Extendicare (the "Preferred Shares"), issuable in series, equal to 50% of the number of Common Shares that are issued and outstanding at the time of the issuance of any series of Preferred Shares, for consideration and on terms and conditions that the Board may determine without the approval of shareholders.

COMMON SHARES

Each Common Share is transferable and represents an equal and undivided beneficial interest in the assets of the Company. Each Common Share entitles the holder to one vote at all meetings of shareholders of the Company. Shareholders are entitled to receive dividends from the Company if, as and when declared by the Board. During 2013, the Company declared cash dividends of $0.60 per share.

PREFERRED SHARES

Preferred Shares may at any time and from time to time be issued in one or more series. There are currently no Preferred Shares issued.

	Share Capital		Unit Capital	
	Shares	Amount	Units	Amount
Balance at January 1, 2012	–	$ –	*84,121,488*	$ 453,150
2012 Conversion	*85,028,197*	460,262	*(85,028,197)*	(460,262)
Transactions with shareholders/unitholders				
DRIP	*974,779*	7,275	*906,709*	7,112
Purchase of shares for cancellation in excess of book value	*(13,600)*	(74)	–	–
Balance at December 31, 2012	*85,989,376*	$ 467,463	–	$ –
Balance at January 1, 2013	***85,989,376***	**$ 467,463**	–	**$** –
Transactions with shareholders				
DRIP	***1,277,135***	**9,017**	–	–
Balance at December 31, 2013	***87,266,511***	**$ 476,480**	–	**$** –

Distribution Reinvestment Plan

The Company has implemented a Distribution Reinvestment Plan (DRIP) pursuant to which shareholders who are residents in Canada may elect to reinvest their cash distributions in additional Common Shares, or prior to the 2012 Conversion, in additional REIT Units or Exchangeable LP Units, as the case may be, on the date of the distribution, at a price equal to 97% of the volume-weighted average trading price of the Common Shares on the TSX for the five trading days immediately preceding the corresponding date of distribution. During 2013, the Company issued 1.3 million Common Shares at a value of $9.0 million in connection with the DRIP (2012 – 0.9 million REIT Units at a value of $7.1 million and 1.0 million Common Shares at a value of $7.3 million).

Normal Course Issuer Bid

On July 5, 2012, Extendicare received the approval of the TSX to commence a normal course issuer bid (the "Bid") to purchase for cancellation up to 4.0 million Common Shares, representing approximately 4.8% of the public float on July 1, 2012. The Bid commenced on July 9, 2012, and provided Extendicare with flexibility to repurchase Common Shares for cancellation until July 8, 2013. The Company did not acquire any shares for cancellation under the Bid during 2013. In July 2012, Extendicare acquired for cancellation 13,600 Common Shares at a cost of $0.1 million (average cost of $7.81 per share).

17. EQUITY RESERVES

Equity reserves are included in AOCI and comprise fair value, and translation reserves, as follows:

	Unrealized Gains/Losses on AFS Securities	Realized Gains/Losses on AFS Securities	Total Fair Value Reserve	Translation Reserve	Total Equity Reserves
Balance, January 1, 2012	1,132	(759)	373	(13,634)	(13,261)
Recognized during the year	1,505	(315)	1,190	(4,867)	(3,677)
Balance, December 31, 2012	2,637	(1,074)	1,563	(18,501)	(16,938)
Recognized during the year	**2,882**	**(335)**	**2,547**	**18,580**	**21,127**
Balance, December 31, 2013	**5,519**	**(1,409)**	**4,110**	**79**	**4,189**

Fair Value Reserve

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale financial assets until the investments are derecognized or impaired.

Translation Reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

18. REVENUE

EHSI derived approximately 77% of its revenue from services provided under the federal (Medicare) and state (Medicaid) programs in 2013 and 79% in 2012. The Medicare program pays each participating center a prospectively set rate for each resident, which is based on the resident's acuity. Most Medicaid programs fund participating centers using a case-mix based system, paying prospectively set rates. With respect to Medicaid in states that utilize retrospective reimbursement systems, nursing centers are paid on an interim basis for services provided, subject to adjustments based upon allowable costs, which are generally submitted in cost reports on an annual basis. In these states, revenue is subject to adjustments as a result of cost report settlements with the state.

Funding received by ECI for its nursing centers and home health care services is regulated by provincial authorities. Revenue from provincial programs represented approximately 68% of ECI's nursing home revenue, and approximately 98% of ECI's home health care revenue for 2013 (2012 – 66% and 97%).

19. EXPENSES BY NATURE

	2013	2012
Employee wages and benefits	**1,363,514**	1,363,719
Food, drugs, supplies and other variable costs	**172,363**	180,984
Property based and other costs	**321,749**	298,471
Total operating expenses and administrative costs	**1,857,626**	1,843,174
Lease costs	**11,096**	10,986
Total expenses	**1,868,722**	1,854,160

20. LOSS FROM ASSET IMPAIRMENT, DISPOSALS AND OTHER ITEMS

	2013	2012
Asset impairment	**8,075**	2,806
Debt settlement	**675**	545
Loss on Kentucky lease transaction	–	3,649
2012 Conversion costs	–	930
2013 strategic review	**2,081**	–
Gain on disposals	**(1,419)**	–
Other	**229**	–
Loss from asset impairment, disposals and other items	**9,641**	7,930

Impairment

We are required to assess for impairment of goodwill on an annual basis, and we performed this assessment for the U.S. operations in the third quarters of 2013 and 2012. Goodwill and corporate assets are allocated to EHSI's CGUs. The carrying value of the assets is then compared to the recoverable amount for each CGU to determine if there is any impairment. The recoverable amount of a CGU is determined to be the greater of fair value less costs to sell and value-in-use calculations. Any impairment loss is allocated first to goodwill, and the remainder to property and equipment. An impairment loss on goodwill cannot be reversed in the future. In respect of property and equipment, if future assessments indicate that there is a change in the estimates used to determine the recoverable amount, the impairment loss will be reversed subject to certain limits.

The determination of recoverable amounts can be significantly impacted by estimates related to current market valuations, current and future economic conditions in the geographical markets of each CGU, and management's strategic plans within each of its markets. Estimates and assumptions used in the determination of the impairment loss were based upon information that was known at the time, along with the future outlook.

The key assumptions used to determine recoverable amounts were as follows:

	2013	2012
Capitalization rates:		
Nursing centers	**11.8%**	12.6%
Assisted living centers	**8.5%**	8.6%
Maintenance capital expenditure per bed	**US$350**	US$300
Management fee as a % of revenue	**5.0%**	5.0%

The recoverable amount calculations used discounted pre-tax cash flow projections determined from financial projections based upon both historical and forecasted amounts on which capitalization rates were applied. The calculation was based on the following key assumptions:

- Cash flows were projected based upon historical financial performance along with the forecast impact of Medicare rate reductions in the coming year and past experience on average daily census, factoring in the historical maintenance capital expenditures and management fees.
- Capitalization rates were based on industry standards on recent transactions.

In September 2013, EHSI recognized a net pre-tax recovery of $0.1 million (US$0.1 million), consisting of a goodwill impairment of $3.7 million (US$3.6 million), an $11.9 million (US$11.5 million) impairment on certain properties and a $15.7 million (US$15.2 million) reversal of a previously recorded impairment loss on property and equipment.

In December 2013, EHSI decided to sell 11 nursing centers, and expects to complete the sale during the next 12 months. Consequently, EHSI recorded an impairment charge of $7.3 million (US$6.8 million) to reduce the net book value of the properties to fair value *(note 8)*.

As for the Canadian operations, based upon the impairment assessment we performed at the end of the year, we recognized a net pre-tax impairment loss of $0.8 million on certain properties.

According to the impairment assessment performed in 2013, a 10-basis point increase in the capitalization rate would cause a $0.1 million increase in goodwill impairment of our U.S. operations and no impairment of goodwill on our Canadian operations, assuming all other variables remained constant.

In September 2012, EHSI recognized a net pre-tax impairment loss of $0.2 million (US$0.2 million), consisting of a goodwill impairment of $1.1 million (US$1.1 million), impairment of $15.2 million (US$15.5 million) on certain properties and a $16.1 million (US$16.4 million) reversal of a previously recorded impairment loss on property and equipment *(note 10).*

In September 2012, ECI recorded an impairment loss of $2.6 million to reduce to fair value an Ontario nursing center that was subsequently closed upon completion of a new center. Also recorded was a debt settlement charge of $0.1 million related to the prepayment penalty on the mortgage for this property.

2013 – Other

In 2013, we recorded charges totalling $0.7 million on the early retirement of debt, in connection with the refinancing of the PrivateBank loans in April 2013 and the Manitoba nursing centers in August 2013 *(note 14).*

As previously disclosed in May 2013, the Board, through its strategic committee (the "Strategic Committee"), has been undertaking a review of strategic alternatives relating to a separation of the Company's Canadian and U.S. businesses that would be in the best interests of the Company and would reasonably be expected to enhance shareholder value. Extendicare confirms that the Strategic Committee continues its work on this initiative and the Company is currently negotiating with one party towards a transaction that may involve the lease and/or sale of some or all of our U.S. assets or business. There is no certainty that a transaction will be completed in the near term, if at all. Material details will be disclosed to the public when available. The Company incurred $2.1 million in advisor fees in 2013 in connection with these activities.

Upon discontinuation of the Alberta home health care operations in August 2013, a charge of $0.2 million was incurred, mostly related to the outstanding lease payments.

During 2013, we sold three Canadian properties that had been closed following the completion of three newly built centers in the same communities: a closed Sault Ste. Marie, Ontario, nursing center (120 beds) for $1.2 million in July 2013, a closed Alberta nursing center (120 beds) for $1.4 million in October 2013, and a closed Timmins, Ontario, nursing center (120 beds) for $1.1 million in November 2013, resulting in pre-tax gains of $0.4 million, $0.4 million and $0.6 million, respectively.

2012 – Other

In May 2012, EHSI entered into an agreement to lease all 21 of its Kentucky skilled nursing centers to an experienced third-party long-term care operator based in Texas that operates through its affiliates in a number of other states *(note 9).* As a result of this transaction, a pre-tax loss of $3.6 million (US$3.6 million) was recorded in 2012.

In July 2012, EHSI prepaid US$10.3 million of HUD-insured mortgages with a weighted average interest rate including MIP of 5.77%. EHSI recorded a $0.8 million (US$0.8 million) loss on refinancing and retirement of debt associated with this transaction.

On October 29, 2012, Extendicare recognized a debt settlement gain of $0.4 million resulting from the redemption of the outstanding aggregate principal amount of the 2013 Debentures of $91.8 million *(note 14).*

Extendicare incurred $0.9 million for transaction costs relating to the 2012 Conversion *(notes 1 and 16).*

21. FINANCE COSTS AND FINANCE INCOME

Convertible Debentures

The fair value adjustment on REIT Issued Convertible Debentures was a gain of $3.1 million for 2013, compared to $4.8 million for 2012. This related to the remeasurement of the liability at fair value at the end of each period.

Transactions between Canadian and U.S. Subsidiaries

We recorded foreign exchange losses of $0.5 million for 2013 and $1.1 million for 2012. These related primarily to the payment of dividends from U.S. subsidiaries to Canadian subsidiaries.

22. EARNINGS PER SHARE

Earnings per share presented have been calculated as if the 2012 Conversion occurred on January 1, 2012. Prior to the 2012 Conversion, the unit capital was considered to be a financial liability, which met certain criteria, allowing it to be presented as equity. As a result, the Company did not previously disclose earnings per unit as the Company did not have equity instruments as defined in IAS 33 Earnings per Share. Upon the 2012 Conversion, the Common Shares meet the definition of an equity instrument; consequently, earnings per share can be computed.

Basic earnings per share are calculated using the weighted average number of shares outstanding during the period. Diluted earnings per share, using the "if-converted" method and to the extent the conversion is dilutive, assume all convertible securities have been converted at the beginning of the period, or at the time of issuance, if later, and any charges or returns on the convertible securities, on an after-tax basis, are removed from net earnings. The after-tax interest on convertible debentures have been removed from net earnings and the weighted average number of shares has been increased by the number of shares, which would be issued on conversion of the convertible debentures, pro-rated for the number of days in the year the convertible debentures were outstanding.

The following table reconciles the numerator and denominator of the basic and diluted earnings per share computation.

	2013	2012
Numerator for Basic and Diluted Earnings per Share		
Earnings from continuing operations		
Net earnings for basic earnings per share	**5,252**	62,656
Less: gain from discontinued operations, net of tax	–	(35,033)
Earnings from continuing operations for basic earnings per share	**5,252**	27,623
Add: after-tax interest on convertible debt	**12,016**	10,531
Less: after-tax gain on fair value adjustment on financial instruments	**(3,099)**	(4,823)
Earnings from continuing operations for diluted earnings per share	**14,169**	33,331
Net earnings		
Net earnings for basic earnings per share	**5,252**	62,656
Add: after-tax interest on convertible debt	**12,016**	10,531
Less: after-tax gain on fair value adjustment on financial instruments	**(3,099)**	(4,823)
Net earnings for diluted earnings per share	**14,169**	68,364
Denominator for Basic and Diluted Earnings per Share		
Weighted average number of shares for basic earnings per share	**86,738,363**	85,039,470
Shares issued if all convertible debt was converted	**16,969,570**	15,380,627
Total for diluted earnings per share	**103,707,933**	100,420,097
Basic Earnings per Share *(in dollars)*		
Earnings from continuing operations	**0.06**	0.32
Earnings from discontinued operations	–	0.42
Net earnings	**0.06**	0.74
Diluted Earnings per Share *(in dollars)*		
Earnings from continuing operations	**0.06**	0.32
Earnings from discontinued operations	–	0.36
Net earnings	**0.06**	0.68

23. DISCONTINUED OPERATIONS

In January 2012, EHSI completed the sale of its GPO to Navigator Group Purchasing, a subsidiary of Managed Health Care Associates, Inc. for $56.7 million (US$56.0 million) and recorded a gain of $56.5 million (US$55.7 million), or $35.0 million after tax (US$34.5 million). GPO's operations have been reclassified as discontinued operations *(note 10)*.

The following is a summary of results of all discontinued operations with prior periods re-presented accordingly.

	2012
Results from Discontinued Operations	
Other revenue	–
Operating expenses	–
Lease costs	–
Total expenses	–
Earnings before depreciation and amortization	–
Depreciation and amortization	–
Gain on asset disposals	(56,453)
Earnings before income taxes	56,453
Income tax expense	21,420
Earnings from discontinued operations	35,033
Cash Flows from Discontinued Operations	
Net cash from operating activities	693
Net cash from investing activities	56,323
Net cash from financing activities	–
Effect on cash flows	57,016

24. INCOME TAXES

Extendicare is the successor to Extendicare REIT following the 2012 Conversion *(note 1)*. Extendicare REIT was a Canadian unincorporated, open-ended limited purpose trust established under the laws of the Province of Ontario by a deed of trust, and was a mutual fund trust and a specified investment flow-through (SIFT) trust for income tax purposes. The REIT was subject to the tax regime applicable to SIFT trusts (the "SIFT Rules") since January 1, 2007.

Under the SIFT Rules, an income trust that is a SIFT trust is subject to tax in respect of certain income that is distributed to its unitholders, at rates that are substantially equivalent to the general corporate tax rate applicable to Canadian corporations. Distributions from income in respect of which this tax is payable will be treated in the same manner as taxable dividends from a taxable Canadian corporation in the hands of unitholders and will be eligible for the enhanced dividend tax credit if paid to an individual resident in Canada. This distribution tax does not apply to distributions by a SIFT trust of taxable dividends received (or deemed to be received) by a SIFT trust from a Canadian corporation or income earned from non-Canadian subsidiaries. Corporate subsidiaries of the REIT were not subject to tax under the SIFT Rules but were instead subject to corporate income tax in the jurisdictions in which they operated.

Tax Recognized in Net Earnings

	2013	2012
Current Tax Expense		
Current year	**13,850**	31,924
Utilization of losses	**(6,007)**	(2,736)
Accelerated tax depreciation	**(4,225)**	(4,124)
Other prior year adjustments	**929**	1,665
	4,547	26,729
Deferred Tax Expense (Recovery)		
Origination and reversal of temporary difference	**(7,846)**	4,111
Utilization of losses	**6,007**	2,736
Accelerated tax depreciation	**4,225**	3,612
Change in statutory tax rate	**–**	805
Change in recognized deductible temporary differences	**(3,590)**	(6,001)
	(1,204)	5,263
Total tax expense	**3,343**	31,992
Tax expense from continuing operations	**3,343**	10,572
Tax expense from discontinued operations	**–**	21,420
Total tax expense	**3,343**	31,992

In respect of the 2009 income tax filings of our U.S. operations, we filed a one-time retroactive change in our U.S. tax accounting method to accelerate the tax depreciation and to expense certain previously capitalized assets that had occurred over the previous seven years. Instead of capitalizing certain expenditures, the tax accounting change expenses those that are frequently required to maintain our properties. This retroactive change is subject to review by the U.S. Internal Revenue Service (IRS).

As a result of this tax accounting change, a recovery of federal and state cash taxes of $24.9 million (US$21.8 million) was recorded in the 2009 fourth quarter, which were received through a reduction of our 2010 U.S. tax instalments. In addition, as at December 31, 2013, further recoveries totalling $15.9 million (US$15.0 million) have been recorded in the years 2010 through 2013. An equal offset to these recoveries, excluding interest, was charged to the deferred income tax provision that will be reversed over time.

Tax Recognized in Other Comprehensive Income (Loss)

	2013			2012		
	Before Tax	**Tax Recovery**	**Net of Tax**	Before Tax	Tax Recovery	Net of Tax
Foreign currency translation differences for foreign operations	**18,580**	**–**	**18,580**	(4,867)	–	(4,867)
Available-for-sale financial assets	**2,547**	**–**	**2,547**	1,190	–	1,190
Deferred benefit plan actuarial losses	**(229)**	**61**	**(168)**	(1,400)	415	(985)
	20,898	**61**	**20,959**	(5,077)	415	(4,662)

Effective Tax Rate

The major factors that caused variations from the expected combined Canadian federal and provincial statutory income tax rates were as follows:

	2013	2012
Earnings from continuing operations before income taxes	**8,595**	38,195
Income taxes at statutory rates of 26.5%	**2,277**	10,121
Income tax effect relating to the following items:		
Tax rate variance of foreign subsidiaries	**2,836**	2,156
Foreign exchange loss	**137**	292
Reversal of previously recognized items	**(2,286)**	(3,640)
Non-deductible items	**1,630**	2,088
Non-taxable income	**(958)**	(1,585)
Other items	**(293)**	1,140
	3,343	10,572

Summary of Operating and Capital Loss Carryforwards

At December 31, 2013, Extendicare's U.S. corporate subsidiaries had net operating loss carryforwards available for U.S. state income tax purposes of $30.4 million (US$28.6 million), which expire in the years 2015 through 2032, and had $11.6 million (US$10.9 million) of net operating loss carryforwards available for U.S. federal income tax purposes, which expire in the years 2021 through 2033. In addition, Extendicare's Canadian corporate subsidiaries had $6.9 million of net operating loss carryforwards available for Canadian federal income tax purposes, which expire in the years 2015 through 2032. To the extent that it is more likely than not that some or all of the deferred tax assets will not be realized, no deferred tax asset has been established.

At December 31, 2013, there were capital losses of $20.3 million (2012 – $21.5 million) available for Canadian income tax purposes that can be carried forward indefinitely to apply against future capital gains. No deferred tax assets have been recognized for the future tax benefit of these capital losses of $2.7 million (2012 – $2.9 million).

Net deferred tax liabilities increased in 2013 by $11.9 million to $192.4 million from $180.5 million at December 31, 2012. Management believes it is more likely than not that Extendicare's corporate subsidiaries will realize the benefits of these deductible differences.

Recognized Deferred Tax Assets and Liabilities

Net deferred tax liabilities comprise the following:

	2013	2012
Deferred tax assets	**7,531**	21,917
Deferred tax liabilities	**199,954**	202,417
Deferred tax liabilities, net	**192,423**	180,500

Deferred income taxes are provided for temporary differences between the carrying values of assets and liabilities and their respective tax values as well as available tax loss carryforwards. The significant components of deferred income tax assets and liabilities and the movement in these balances during the year were as follows:

	Balance January 1, 2012	Recognized in Net Earnings	Recognized in Other Comprehensive Loss	Other	Recognized in Other Comprehensive Loss re: FX	Balance December 31, 2012
Deferred tax liabilities						
Property and equipment	234,298	233	–	–	(4,501)	230,030
Leasehold rights	265	(265)	–	–	–	–
Other	18,416	(2,918)	–	–	(297)	15,201
	252,979	(2,950)	–	–	(4,798)	245,231
Deferred tax assets						
Self-insurance reserves	13,304	(5,116)	–	–	(260)	7,928
Employee benefit accruals	20,664	(3,897)	415	–	(252)	16,930
Operating loss carryforwards	10,897	(1,149)	–	–	70	9,818
Deferred revenue	4,443	(960)	–	–	–	3,483
Accounts receivable reserves	2,439	1,182	–	–	(59)	3,562
Decommissioning provision	8,550	608	–	–	(147)	9,011
Other	13,108	1,119	–	–	(228)	13,999
	73,405	(8,213)	415	–	(876)	64,731
Deferred tax liabilities, net	179,574	5,263	(415)	–	(3,922)	180,500

	Balance January 1, 2013	**Recognized in Net Earnings**	**Recognized in Other Comprehensive Income**	**Other**	**Recognized in Other Comprehensive Income re: FX**	**Balance December 31, 2013**
Deferred tax liabilities						
Property and equipment	**230,030**	**(3,713)**	**–**	**–**	**13,870**	**240,187**
Other	**15,201**	**4,743**	**–**	**1,023**	**1,281**	**22,248**
	245,231	**1,030**	**–**	**1,023**	**15,151**	**262,435**
Deferred tax assets						
Self-insurance reserves	**7,928**	**647**	**–**	**–**	**555**	**9,130**
Employee benefit accruals	**16,930**	**(78)**	**61**	**–**	**505**	**17,418**
Operating loss carryforwards	**9,818**	**(6,925)**	**–**	**–**	**71**	**2,964**
Deferred revenue	**3,483**	**(91)**	**–**	**–**	**–**	**3,392**
Accounts receivable reserves	**3,562**	**1,771**	**–**	**–**	**301**	**5,634**
Decommissioning provision	**9,011**	**1,729**	**–**	**–**	**545**	**11,285**
Other	**13,999**	**5,181**	**–**	**–**	**1,009**	**20,189**
	64,731	**2,234**	**61**	**–**	**2,986**	**70,012**
Deferred tax liabilities, net	**180,500**	**(1,204)**	**(61)**	**1,023**	**12,165**	**192,423**

25. COMMITMENTS AND CONTINGENCIES

Operating Lease Commitments

At December 31, 2013, the Company was committed under non-cancellable leases requiring future minimum rentals as follows:

	Operating Leases
2014	8,468
2015	6,757
2016	6,319
2017	5,704
2018	4,663
2019 and beyond	5,994
Total minimum payments	37,905

Property and Equipment Commitments

As at December 31, 2013, outstanding capital expenditure commitments for EHSI totalled \$9.5 million (US\$9.0 million), \$6.4 million (US\$6.0 million) of which represented a commitment entered into in August 2013 to purchase an Ohio skilled nursing center (108 beds) that is currently being leased; and those for ECI totalled \$3.3 million, which related to the remaining costs on the Timmins redevelopment project *(note 9)*.

Finance Lease Obligations

In June 2009, EHSI entered into an agreement with an unrelated party who constructed a 100-bed skilled nursing center in South Bend, Indiana. Effective November 2010, under the terms of the agreement, EHSI entered into a 10-year finance lease and recorded a US\$12.5 million purchase of property and equipment and a US\$12.5 million finance lease obligation. In December 2012, EHSI exercised its option under the agreement and purchased this center for US\$13.2 million in cash, consisting of the US\$12.5 million in repayment of the finance lease obligation and a US\$0.7 million purchase of property and equipment *(note 14)*.

In September 2009, EHSI entered into an agreement with the company controlled by the former shareholders of Tendercare, which includes a partial interest of Mr. Lukenda, our President and Chief Executive Officer, and his immediate family *(note 29)*. EHSI owns a 120-bed skilled nursing center in Lansing, Michigan. Effective January 1, 2011, under the terms of the agreement and immediately following the renovation of the center, EHSI entered into a 10-year operating lease for US\$0.4 million per annum. The center was certified in March 2011, and the lease expires on January 1, 2021.

ALC Spin-Off

In connection with the distribution by Extendicare of shares of Assisted Living Concepts, Inc. (ALC) to shareholders of Extendicare in 2006, Extendicare, EHSI and ALC entered into a number of transactions and agreements including a separation agreement (the "Separation Agreement") and a number of agreements relating to the transfer of assisted living centers from EHSI to ALC. Pursuant to the Separation Agreement, ALC has agreed to indemnify, defend and hold harmless Extendicare and certain of its related parties for identifiable losses relating to or arising from certain specified matters, including matters relating to or arising from ALC's assisted living care business and Extendicare has agreed to indemnify, defend and hold harmless ALC and certain related parties from certain other specified matters, including matters relating to those assets and liabilities that were not transferred to ALC as part of the separation.

LTC MASTER LEASES

Both ALC and EHSI are the lessees under lease agreements with LTC Properties, Inc. (LTC) (the "LTC Master Leases"), which cover 37 assisted living properties operated solely by ALC that are not part of EHSI's operations. LTC declined to remove EHSI as a party to the leases at the time of the distribution of ALC by Extendicare to its shareholders in 2006 and accordingly, EHSI continues to be directly liable to LTC for rent payments and other obligations owing under the LTC Master Leases, notwithstanding that EHSI does not have any financial interest in the operations of the 37 centers. The Separation Agreement entered into between Extendicare and ALC provides that ALC will indemnify EHSI against any expenses, liabilities and costs incurred by EHSI, including rent payments relating to the LTC Master Leases. The aggregate minimum rental payments for the 2013 calendar year were approximately US\$11.8 million and will increase by 2% for the 2014 calendar year. The leases expire in December 2014, and in January 2014, LTC announced that it does not intend to renew the leases with ALC.

In July 2013, all of the outstanding shares of ALC were acquired by an affiliate of TPG Capital, L.P. (TPG), a global private investment firm, for cash. Management does not believe that this transaction will have an impact on either EHSI being a co-tenant under the LTC Master Leases, nor the indemnification between Extendicare and ALC provided within the Separation Agreement.

Extendicare has not recorded any potential liability for this exposure.

2006 DISTRIBUTION

In connection with the spin-off of ALC in 2006, EHSI received a note upon the transfer of ALC to its Canadian affiliate, which note was subsequently repaid by way of cash, settlement against other notes and dividends of US$476.6 million. Based upon internal calculations, management believes there was sufficient surplus and basis as to not attract any Canadian taxes from the transactions relating to the repayment of the note. Extendicare and its Canadian affiliates are currently under audit by the Canada Revenue Agency (CRA). Should the CRA determine that the available surplus was less than the amount determined by management, Canadian capital gains taxes would apply to the shortfall.

Legal Proceedings and Regulatory Actions

The provision of health care services is subject to complex federal, state and provincial laws and regulations, including laws and regulations that are intended to prevent health care fraud and abuse. Extendicare and its consolidated subsidiaries are defendants in various actions and proceedings that are brought against them from time to time in connection with their operations. Recently adopted U.S. health care reform legislation has resulted in an increase in government oversight of the long-term care industry and, as a result, long-term care providers, including Extendicare, are experiencing an increase in government surveys, investigations, audits and scrutiny of their operations. In such circumstances, Extendicare cooperates in responding to information requests and takes the necessary corrective actions. Extendicare accrues for costs that may result from investigations to the extent that an outflow of funds is probable and a reliable estimate of the amount of the associated costs can be made.

As a result of any determination that Extendicare has violated the U.S. Social Security Act or other applicable laws and regulations in connection with a government investigation or otherwise, or in connection with any settlement of an allegation of the same, Extendicare may incur significant costs, fines, civil monetary penalties, recoupments and administrative penalties (including suspension or exclusion from participation in Medicare, Medicaid and other provider programs) and suffer other sanctions. Among other things, as part of the settlement of any investigation or as a result of litigation relating to an investigation, the Company may be required to assume specific procedural and financial obligations under a corporate integrity agreement, which would typically require the Company to retain a third-party monitor and to implement various new reporting and employee training requirements, and/or other arrangement with the government. Any of these outcomes could have a material adverse effect on the business, results of operations and consolidated financial position of Extendicare.

As previously disclosed, EHSI has received subpoenas from the U.S. Department of Health and Human Services, Office of the Inspector General (OIG) relating to the submission of claims that the OIG believes may be in violation of the U.S. Social Security Act. Starting in November 2012, representatives of the OIG and the U.S. Department of Justice (DOJ) have been meeting with senior representatives of EHSI to discuss the OIG's and DOJ's investigations into the submission of claims that relate to the quality of care provided to residents and patients of EHSI's skilled nursing centers and the provision of rehabilitation services. EHSI has continued to work cooperatively with the OIG and DOJ and settlement discussions between EHSI and the OIG and DOJ have been ongoing with a view to resolving the investigations on a nationwide basis. The settlement discussions include the requirement that EHSI enter into a corporate integrity agreement with the OIG, the principal terms and conditions of which have not been agreed to. If EHSI enters into a corporate integrity agreement or incurs any fines, penalties or recoupment as part of a settlement of the OIG and DOJ investigations described above, it would not be an admission by EHSI that EHSI or any of its subsidiaries provided substandard patient care or medically unnecessary rehabilitation services. As at February 26, 2014, settlement discussions between the OIG and DOJ and EHSI and its outside counsel were not sufficiently advanced for EHSI to be able to predict the possible outcomes of the investigations (or any possible related litigation if a settlement with the OIG and DOJ is not reached) and the Company is unable to reliably estimate the range or the amount of the associated costs or loss that may be incurred. Any settlement or the outcome of any related litigation could involve the payment of substantial sums and other sanctions that could have a material adverse effect on the Company's business, results of operations or consolidated financial position. EHSI believes that it is in material compliance with the U.S. Social Security Act and other applicable federal and state laws and regulations.

26. EMPLOYEE BENEFITS

Retirement compensation arrangements are maintained for certain employee groups as described below.

Defined Benefit Plans

Extendicare has pension arrangements for certain of its executives, which include a registered defined benefit pension plan, as well as a supplementary plan that provide pension benefits in excess of statutory limits. Both of these plans have been closed to new entrants for several years. The plans are exposed to various risks, including longevity risk, currency risk, interest rate risk and market risks.

The different types of defined benefit plans of the Company are listed below.

	Funded Defined Benefit Plan		Unfunded Supplementary Defined Benefit Plan		Total	
	2013	2012	**2013**	2012	**2013**	2012
Fair value of plan assets	**5,664**	5,683	**–**	–	**5,664**	5,683
Present value of obligations	**7,267**	7,648	**33,605**	33,840	**40,872**	41,488
Deficit	**(1,603)**	(1,965)	**(33,605)**	(33,840)	**(35,208)**	(35,805)

FUNDING

As required by law, the registered defined benefit pension plan benefits are funded through a trust, and the Company is responsible for meeting the statutory obligations for funding this plan. The funding requirement for past service is determined based on separate actuarial valuations for funding purposes, which are completed every three years. The most recent actuarial review was performed effective October 1, 2012, and was completed in early 2013.

The supplementary plan is unfunded and pension benefits are secured through a letter of credit that is renewed annually. We do not set aside assets for this plan and the benefit payments are funded from our cash from operations.

DEFINED BENEFIT OBLIGATIONS

	2013	2012
Present Value of Defined Benefit Obligations		
Accrued benefit obligations		
Balance at beginning of year	**41,488**	40,840
Current service cost	**156**	162
Benefits paid	**(2,851)**	(2,621)
Interest costs	**1,512**	1,587
Actuarial losses	**567**	1,520
Balance at end of year	**40,872**	41,488
Plan assets		
Fair value at beginning of year	**5,683**	5,644
Employer contributions	**87**	–
Expected return on assets	**338**	257
Actual return on plan assets	**207**	217
Benefits paid	**(651)**	(435)
Fair value at end of year	**5,664**	5,683
Defined benefit obligations	**35,208**	35,805

The expected contribution for the coming year is approximately $2.3 million.

	2013	2012
Reported in Extendicare's Statements of Financial Position		
Current accrued liabilities	**2,219**	2,186
Other long-term liabilities *(note 14)*	**32,989**	33,619
Accrued benefit liability at end of year	**35,208**	35,805

EFFECT OF CHANGES TO DEFINED BENEFIT OBLIGATIONS

	2013	2012
Expense Recognized in Net Earnings		
Annual benefit plan expense		
Current service costs	**156**	162
Interest cost	**1,305**	1,370
Plan benefit expense recognized in the year – included in operating expenses and administrative costs	**1,461**	1,532

	2013	2012
Actuarial Gains or Losses Recognized in Other Comprehensive Income (Loss)		
Amount accumulated in accumulated deficit at January 1	**(6,462)**	(5,477)
Actuarial loss arising from changes in:		
Discount rate	**3,034**	(1,115)
Mortality assumption	**(2,548)**	–
Other experience	**(1,053)**	(405)
Return on assets	**338**	121
Income tax recovery on actuarial loss	**61**	414
Amount recognized in accumulated deficit at December 31	**(6,630)**	(6,462)

PLAN ASSETS

	2013	2012
Equities	**66%**	64%
Fixed income securities	**34%**	33%
Cash and short-term investments	–	3%
	100%	100%

ACTUARIAL ASSUMPTIONS

	2013	2012
Discount rate for year-end accrued obligation	**4.50%**	3.75%
Discount rate for period expense	**3.75%**	4.00%
Rate of compensation increase	**2.0%**	2.0%
Income Tax Act limit increase	**3.0%**	3.0%
Average remaining service years of active employees	**4**	5

The present value of the pension obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of pension obligations.

Extendicare determines the appropriate discount rate at the end of each year. This is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Company considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and those that have terms to maturity approximating the terms of the related pension liability.

Changes to the following actuarial assumptions, while holding the other assumptions constant, would have affected the defined benefit obligation and related expense for 2013 by the amounts shown below.

	Increase (Decrease) in Benefit Obligation	Increase (Decrease) in Net Earnings
Discount rate:		
1% increase	(3,918)	(104)
1% decrease	4,670	150
Rate of compensation increase		
1% increase	47	(4)
1% decrease	(46)	4
Income Tax Act limit increase		
1% increase	–	–
1% decrease	–	–
Mortality rate		
10% increase	(692)	32
10% decrease	753	(37)

Defined Contribution Plans

Both Canada and the U.S. offer defined contribution plans. Canada maintains registered savings and defined contribution plans, while EHSI maintains defined contribution retirement 401(k) savings plans in the U.S. Canada matches up to 120% of the employees' contributions according to seniority, subject to a maximum based on the salary of the plan participants. Contributions expensed by Canada in 2013 and 2012 were $12.5 million and $11.9 million, respectively. EHSI pays a discretionary matching contribution. Contributions expensed by EHSI in 2013 and 2012 were US$2.7 million and US$1.5 million, respectively.

27. MANAGEMENT OF RISKS AND FINANCIAL INSTRUMENTS

a) Management of Risks

REFINANCING RISK

The 2014 Debentures mature on June 30, 2014, and require Extendicare to either repay the 2014 Debentures in full or refinance them through the capital markets. Management continues to closely monitor the financial markets and believes that the Company has the full financial capacity and ability to execute a plan to complete the refinancing. Although management has the confidence to complete the refinancing, there can be no assurance given that the Company will succeed in the refinancing of the 2014 Debentures prior to their maturity.

MANAGEMENT OF LIQUIDITY RISK

Liquidity risk is the risk that the Company will encounter difficulty in meeting its contractual obligations. We manage our liquidity risk through the use of budgets and forecasts. Cash requirements are monitored regularly based on actual financial results and actual cash flows to ensure that there are sufficient resources to meet operational requirements. We ensure that there are sufficient funds for declared and payable distributions and any other future commitments at any point in time. In addition, since there is a risk that long-term debt may not be refinanced or may not be refinanced on as favourable terms or with interest rates as favourable as those of the existing debt, we attempt to appropriately structure the timing of contractual long-term debt renewal obligations and exposures.

The following are the contractual maturities of financial liabilities, including estimated interest payments:

As at December 31, 2013	Carrying Amount	Contractual Cash Flows	Less than 1 Year	1–2 Years	2–5 Years	More than 5 Years
Convertible debentures	**235,816**	**294,910**	124,767	7,590	22,770	139,783
Line of Credit	**2,234**	**2,479**	123	2,356	–	–
HUD mortgages	**576,715**	**1,037,369**	35,070	34,990	104,559	862,750
HUD mortgages – held for sale(1)	**10,708**	**18,440**	647	646	1,930	15,217
CMHC mortgages	**175,762**	**224,827**	24,922	18,367	77,485	104,053
Non-CMHC mortgages	**95,688**	**168,501**	7,091	7,321	21,899	132,190
Finance lease obligations	**107,978**	**167,286**	13,730	12,774	36,378	104,404
Notes payable	**72**	**72**	72	–	–	–
Accounts payable and accrued liabilities	**229,389**	**229,389**	229,389	–	–	–
Accounts payable and accrued liabilities – held for sale(1)	**4,752**	**4,752**	4,752	–	–	–
	1,439,114	**2,148,025**	440,563	84,044	265,021	1,358,397

(1) These items have been classified as liabilities held for sale, and are included as part of accounts payable and accrued liabilities *(note 8)*.

As at December 31, 2012	Carrying Amount	Contractual Cash Flows	Less than 1 Year	1–2 Years	2–5 Years	More than 5 Years
Convertible debentures	238,240	301,404	14,084	124,767	22,770	139,783
Line of Credit	8,059	9,328	423	423	8,482	–
HUD mortgages	521,576	960,532	31,704	31,662	94,715	802,451
PrivateBank loans	33,774	35,800	35,800	–	–	–
CMHC mortgages	189,209	243,785	35,857	23,117	70,769	114,042
Non-CMHC mortgages	15,533	16,277	16,277	–	–	–
Finance lease obligations	112,983	179,917	12,912	13,205	37,292	116,508
Construction loans	39,652	75,255	2,408	2,980	8,946	60,921
Notes payable	4,048	4,346	4,312	34	–	–
Accounts payable and accrued liabilities	237,909	237,909	237,909	–	–	–
	1,400,983	2,064,553	391,686	196,188	242,974	1,233,705

The gross outflows presented above represent the contractual undiscounted cash flows.

MANAGEMENT OF CREDIT RISK

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the Company by failing to discharge its obligation. The nature and maximum exposure to credit risk as at December 31 was:

	Carrying Amount	
	2013	2012
Cash and short-term investments	**95,999**	71,398
Restricted cash *(note 14)*	**18,668**	28,680
Total receivables, net of allowance(1) *(note 6)*	**220,643**	220,913
Investments held for self-insured liabilities *(note 11)*	**118,827**	115,025
Notes, mortgages and amounts receivable *(note 11)*	**84,896**	50,037
	539,033	486,053

(1) Includes non-current portion.

Cash and Short-term Investments

The majority of our cash and short-term investments are held with highly rated financial institutions in Canada and the United States.

Restricted Cash

The restricted cash is cash held mainly for collateral and regulatory requirements with no credit risk *(note 14)*.

Total Receivables, Net of Allowance

The maximum exposure to credit risk for accounts receivable at the reporting date is the carrying value of each class of receivable, denominated in the following currencies. The Company does not hold any collateral as security.

	2013			2012		
	Carrying Amount			Carrying Amount		
	U.S. Dollar	**Canadian Dollar**	**Total**	U.S. Dollar	Canadian Dollar	Total
Trade receivables	**155,973**	**17,499**	**173,472**	146,667	18,905	165,572
Retroactive rate receivables	**13,287**	**3,021**	**16,308**	23,652	2,251	25,903
Other receivables	**14,297**	**16,566**	**30,863**	17,412	12,026	29,438
	183,557	**37,086**	**220,643**	187,731	33,182	220,913

Receivables from U.S. and Canadian government agencies, which are included in accounts receivable, notes, mortgages and amounts receivable, and Medicare and Medicaid settlement receivables, represented the only concentrated group of credit risks for the Company. As at December 31, 2013, receivables from government agencies represented approximately 71% of the total receivables. Management does not believe that there is significant credit risk associated with these government agencies other than possible funding delays. Management continuously monitors reports from trade associations or notes from provincial, state or federal agencies that announce possible delays that are rare to occur and usually associated with changes of fiscal intermediaries or changes in information technology or forms.

Receivables, other than those from government agencies, consist of receivables from various payors and do not represent any concentrated credit risks to the Company. There is no significant exposure to any single party.

As at December 31, 2013, the U.S. operations (mainly EHSI) had trade receivables of $156.0 million (2012 – $146.7 million), which were fully performing and collectible in the amounts outlined above. EHSI continuously monitors the collection of all trade receivables and assesses the collectability of accounts on an individual basis in addition to the aging of the balances by payor type. The majority of balances between 90 and 365 days pertain to residents awaiting confirmation of Medicaid eligibility or those involving deferred claims with Health Maintenance Organizations (HMOs); whereas the balances over 365 days primarily involve claims against private residents that were denied HMO or Medicaid benefits. In 2013, EHSI incurred a provision for receivable impairment of $19.1 million (2012 – $18.4 million).

As at December 31, 2013, retroactive rate receivables of $13.3 million (2012 – $23.7 million) primarily pertain to reimbursable bad debt claims under the Medicare program along with rate settlements involving cost-based state Medicaid programs with retrospective systems of reimbursement.

As at December 31, 2013, ECI had trade receivables of $17.5 million (2012 – $18.9 million) which were fully performing and collectible in the amounts outlined above. ECI continuously monitors the collection of all trade receivables and assesses the collectability of accounts on an individual basis in addition to the aging of the balances by payor type. The majority of balances over 365 days involve amounts due from private individuals. ECI incurred a provision for receivable impairment of $0.6 million in each of 2013 and 2012.

The aging analysis of these trade receivables is as follows:

	2013	2012
Current	**103,316**	101,330
Between 30 and 90 days	**61,618**	48,900
Between 90 and 365 days	**25,755**	25,741
Over 365 days	**11,719**	8,053
Less: provision for receivable impairment	**(21,155)**	(18,452)
	181,253	165,572
Less: assets held for sale	**(7,781)**	–
Total	**173,472**	165,572

Movements on the Company's provision for receivable impairment are as follows:

	2013	2012
At January 1	**18,452**	16,675
Increase in provision for receivable impairment	**19,745**	18,951
Receivables written off as uncollectible	**(18,293)**	(16,827)
Other	**1,251**	(347)
At December 31	**21,155**	18,452

The increase in provision for receivables impairment has been included in operating expenses in net earnings. In general, amounts charged to the provision for impairment of trade receivables are written off when there is no expectation of recovering additional cash.

Investments for Self-insured Liabilities

The Company's investments held for self-insured liabilities include investments in corporate or government fixed-rate bonds with ratings above a rating of AAA- along with U.S. treasuries. Cash held for self-insured liabilities are with high-quality financial institutions. The Company limits the amount of exposure to any one institution.

Notes, Mortgages and Amounts Receivable

Included in notes, mortgages and amounts receivable were $66.8 million (2012 – $34.3 million) of discounted amounts receivable due from government agencies. These represent amounts funded by the Ontario government for a portion of nursing home construction costs over a 20-year or 25-year period *(note 11)*. The Company does not believe there is any credit exposure for these amounts due from government agencies.

MANAGEMENT OF CURRENCY RISK

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Company finances and secures Canadian debt on only Canadian operations and assets; and similarly, finances and secures U.S. debt on only U.S. operations and assets. Therefore, there is no currency exposure in respect of the valuation of assets and associated debt. The Company can raise capital to finance its U. S. operations through cross-border loans or an injection of capital. Intercompany advances to the U.S. operations for acquisitions or growth expenditures are subsequently repaid. Any cross-border transactions are subject to exchange fluctuations that may result in realized gains or losses as and when the balances are settled and upon the payment of interest on such loans, as well as any cross-border dividend or return of capital.

Our exposure to foreign currency risk as at December 31, 2013 and 2012, was as follows:

(in thousands of US$)	**2013**	2012
Assets		
Current assets	**275,906**	254,320
Property and equipment, goodwill and other intangibles, and other assets	**970,682**	1,051,882
Liabilities		
Current liabilities	**196,351**	225,651
Long-term debt and other liabilities	**795,363**	805,502
Net asset exposure	**254,874**	275,049

Net Earnings Sensitivity Analysis

The majority of the Company's operations are conducted in the United States, which accounted for approximately 63% of its total revenue in 2013.

Every one cent strengthening of the Canadian dollar against the U.S. dollar would impact net earnings and OCI by the amounts shown below. This analysis assumes that all other variables, in particular the interest rates, remain constant.

Unfavourable impact	**2013**	2012
Net earnings	**–**	–
Other comprehensive income	**(2,549)**	(2,750)

Cash Flow Sensitivity

All of the Company's dividends are denominated in Canadian dollars; therefore, to the extent these dividends are funded by our U.S. operations, the Company is subject to currency risk. To limit the exposure of converting the Company's U.S. cash flow into Canadian dollars, we monitor the U.S. to Canadian dollar and, should the conditions be considered favourable, implement a foreign currency hedging strategy through the purchase of FCFCs.

The Company maintains risk management control systems to monitor foreign currency cash flow risk attributable to its outstanding or forecasted debt obligations as well as its offsetting hedge positions. We do not enter into financial instruments for trading or speculative purposes.

MANAGEMENT OF INTEREST RATE RISK

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company assesses interest rate risk by continuously identifying and monitoring changes in interest rates that may adversely impact expected future cash flows and by evaluating hedging opportunities. The Company maintains risk management control systems to monitor interest rate risk attributable to its outstanding or forecasted debt obligations as well as its offsetting hedge positions.

In order to meet its monthly dividends, the Company has limited the amount of debt that may be subject to changes in interest rates. As at December 31, 2013, 99.8% of our outstanding long-term debt was at fixed rates and $2.2 million of long-term debt was subject to interest rate fluctuations. We do not enter into financial instruments for trading or speculative purposes.

The interest rate profile of our interest-bearing financial instruments at December 31, 2013 and 2012, was as follows:

	Carrying Amount	
	2013	2012
Fixed-rate instruments:		
Investments held for self-insured liabilities[1]	**81,964**	97,108
Less: Long-term debt[2]	**1,192,031**	1,121,241
Long-term debt – held for sale[2] *(note 8)*	**10,708**	–
Net liability in fixed-rate instruments	**1,120,775**	1,024,133
Variable-rate instruments:		
Long-term debt[2]	**2,234**	41,833
Total liability in variable-rate instruments	**2,234**	41,833

(1) Excludes variable-rate instruments.

(2) Includes current portion and excludes netting of financing costs.

Fair Value Sensitivity Analysis for Fixed-rate Instruments

We do not designate interest rate derivatives as hedging instruments under a fair-value hedge accounting model; therefore, changes in interest rates would not affect net earnings with respect to these fixed-rate instruments. As at December 31, 2013, there were no fixed-rate instruments designated as held for trading; therefore, changes in interest rates will not have any impact on net earnings for these instruments.

Fair Value Sensitivity Analysis for Variable-rate Instruments

All long-term debt with variable rates are classified as other financial liabilities, which are measured at amortized cost using the effective interest method of amortization; therefore, changes in interest rates would not affect OCI with respect to variable-rate debt.

Cash Flow Sensitivity Analysis for Variable-rate Instruments

A change of 100 basis points in interest rates would have increased or decreased net earnings by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant.

	2013		2012	
Favourable (unfavourable) impact	**100bp Increase**	**100bp Decrease**	100bp Increase	100bp Decrease
Net earnings	**(15)**	**15**	(353)	353

b) Fair Values of Financial Instruments

As at December 31, 2013	**Loans and Receivables**	**Available for Sale**	**Designated at Fair Value**	**Other Financial Liabilities**	**Total Carrying Amount**	**Fair Value**
Financial assets:						
Cash and short-term investments	**95,999**	–	–	–	**95,999**	**96,005**
Restricted cash	**18,668**	–	–	–	**18,668**	**18,668**
Invested assets[1]	**442**	–	–	–	**442**	**442**
Trade and other receivables	**216,608**	–	–	–	**216,608**	**215,999**
Notes, mortgages and amounts receivable[2]	**88,931**	–	–	–	**88,931**	**94,402**
Investments held for self-insured liabilities	–	**118,827**	–	–	**118,827**	**118,827**
	420,648	**118,827**	–	–	**539,475**	**544,343**
Financial liabilities:						
Accounts payable	–	–	–	**31,030**	**31,030**	**31,030**
Long-term debt excluding convertible debentures[2][3]	–	–	–	**958,449**	**958,449**	**954,568**
Convertible debentures	–	–	**114,226**	**121,590**	**235,816**	**241,991**
	–	–	**114,226**	**1,111,069**	**1,225,295**	**1,227,589**

As at December 31, 2012	Loans and Receivables	Available for Sale	Designated at Fair Value	Other Financial Liabilities	Total Carrying Amount	Fair Value
Financial assets:						
Cash and short-term investments	71,398	–	–	–	71,398	71,398
Restricted cash	28,680	–	–	–	28,680	28,680
Invested assets[1]	458	–	–	–	458	458
Trade and other receivables	217,989	–	–	–	217,989	217,480
Notes, mortgages and amounts receivable[2]	52,961	–	–	–	52,961	59,079
Investments held for self-insured liabilities	–	115,025	–	–	115,025	115,025
	371,486	115,025	–	–	486,511	492,120
Financial liabilities:						
Accounts payable	–	–	–	35,508	35,508	35,508
Long-term debt excluding convertible debentures[2][3]	–	–	–	924,834	924,834	988,917
Convertible debentures	–	–	117,325	120,915	238,240	247,620
	–	–	117,325	1,081,257	1,198,582	1,272,045

(1) Included in other current assets.

(2) Includes current portion.

(3) Excludes financing costs.

BASIS FOR DETERMINING FAIR VALUES

The following summarizes the significant methods and assumptions used in estimating the fair values of financial instruments reflected in the previous table.

Fair values for investments designated as available for sale are based on quoted market prices.

Items designated as loans and receivables include cash, accounts receivable as well as notes, mortgages and amounts receivable. Accounts receivable, including other long-term receivables, are recorded at amortized cost. The carrying values of accounts receivable approximate fair values due to their short-term maturities, with the exception of certain settlement receivables from third-party payors that are anticipated to be collected beyond one year. The fair values of these settlement receivables are estimated based on discounted cash flows at current borrowing rates. Notes, mortgages and amounts receivable primarily consist of notes and amounts receivable from government agencies, and other third-party notes. The fair values for these instruments are based on the amount of future cash flows associated with each instrument, discounted using current applicable rates for similar instruments of comparable maturity and credit quality. The fair values of convertible debentures are based on the closing price of the publicly traded convertible debentures on each reporting date, and the fair values of mortgages and other debt are estimated based on discounted future cash flows using discount rates that reflect current market conditions for instruments with similar terms and risks.

FAIR VALUE HIERARCHY

We use a fair value hierarchy to categorize the type of valuation techniques from which fair values are derived. Our use of quoted market prices (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information as inputs (Level 3) for the following financial instruments recorded at fair value were as follows:

As at December 31, 2013	**Level 1**	**Level 2**	**Level 3**	**Total**
Available-for-sale securities	**118,827**	–	–	**118,827**
Financial liabilities designated at fair value through profit or loss	–	**114,226**	–	**114,226**

As at December 31, 2012	Level 1	Level 2	Level 3	Total
Available-for-sale securities	115,025	–	–	115,025
Financial liabilities designated at fair value through profit or loss	–	117,325	–	117,325

28. CAPITAL MANAGEMENT

The Company's objective is to preserve a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. We seek to balance the need for maintaining an attractive payout ratio while preserving adequate capital to grow the business by acquisition or internal growth. There were no changes in the Company's approach to capital management during the year.

The Company must access the capital markets periodically to fund acquisitions, growth capital expenditures and certain other expenditures. We monitor the capital markets to assess the conditions for raising capital and the cost of such capital relative to the return on any acquisitions or growth capital projects. Funds raised in the capital markets that are not deployed in acquisitions or growth projects are held in high-quality investments with surplus cash held in secure institutions. We manage our cash position and prepare monthly cash flow projections over the remaining and future fiscal period, and we continuously monitor the level, nature and maturity dates of debt and level of leverage and interest coverage ratios to ensure our compliance with debt covenants. We provide information to the Board on a regular basis in order to carefully evaluate any significant cash flow decisions.

Economic Environment

The global and U.S. economy has had an indirect impact on the long-term care industry since the 2008 downturn due to the unprecedented loss of jobs in the U.S., reduction of health care benefits along with the loss of disposable income for elective health care services. As a result, there has been a reduction in admissions to our U.S. nursing centers and a concerted effort by federal, provincial and state governments to restrain or reduce funding of health programs. In response to the economic environment, Extendicare has undertaken several courses of action to minimize risks and maintain liquidity, including:

- reducing growth projects along with divestiture of underperforming assets and non-core businesses;
- implementing significant cost reduction initiatives;
- refinancing a significant portion of long-term debt with low-cost government-insured mortgages;
- monitoring cash usage; and
- maintaining solid banking relationships.

For the near term, there are no indications that the economy and economic risks affecting the industry are improving. Therefore, Extendicare plans to continue to monitor and implement steps to address these challenges. Below is a summary of the past and future uncertainties and significant risks that could have a material impact on Extendicare and its subsidiaries.

STATE, PROVINCIAL AND FEDERAL FUNDING AND REGULATORY PRESSURE

Reductions in Medicaid, Medicare and provincial funding for long-term care due to the economic downturn could have a material adverse effect on our earnings. Our business is highly labour intensive, with labour costs representing approximately 73% of our consolidated operating costs for 2013 and 2012. As a result of resident care needs and regulatory requirements, we have limited ability to reduce or manage our labour costs. In addition, any escalation of regulatory pressure by CMS, state or provincial level government agencies could have a negative impact on our operating costs and thereby reduce our earnings.

A number of states in which we operate have faced severe budgetary shortfalls, resulting in reductions in Medicaid funding or increases at rates below inflation. The temporary increase in funding for state Medicaid programs, through the federal medical assistance percentage, or FMAP funding increase, ended on June 30, 2011. As a result, a number of states are facing considerable financial pressures that could result in future Medicaid rate reductions, despite some economic improvement in certain regions.

Effective October 1, 2011, CMS implemented reductions in Medicare funding to skilled nursing centers, along with other changes. We have taken measures to help mitigate the adverse effect of the elimination of group therapy and the assessment process changes, such as employing more therapists and improving productivity. In addition, EHSI took action to reduce operational and corporate office staff and realize savings in supplies, drugs, and third-party service arrangements with vendors, the majority of which were implemented by October 1, 2011, and the balance by the beginning of 2012. None of these cost saving measures involved a reduction of direct care staffing at our centers.

Normal Course Issuer Bid

On July 5, 2012, Extendicare received approval of the TSX for the Bid *(note 16)*. There were no purchases for cancellation made under a similar normal course issuer bid that expired on January 10, 2012.

Capital Structure

The Company defines its capital structure to include long-term debt, net of cash and short-term investments, and share/unit capital.

	2013	2012
Current portion of long-term debt[(1)]	**148,051**	93,448
Long-term debt[(1)]	**1,016,785**	1,038,787
Total debt	**1,164,836**	1,132,235
Less: cash and short-term investments	**(95,999)**	(71,398)
Net debt	**1,068,837**	1,060,837
Share capital	**476,480**	467,463
	1,545,317	1,528,300

(1) Net of financing costs.

Dividends

The declaration and payment of future distributions is at the discretion of our Board and will be dependent upon a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of Extendicare, debt covenants and obligations, and any other factors deemed relevant by the Board. If our Board determines that it would be in Extendicare's best interests, it may reduce, for any period, the amount and frequency of dividends to be distributed to holders of Common Shares.

Financial Covenants

EHSI is subject to external financial covenant requirements pursuant to the EHSI Credit Facility on the level of debt to earnings and cash flow of its operations; and ECI is also subject to external requirements for certain of its loans on the level of debt to cash flow of its operations *(note 14)*. Management and the Board monitor these covenant ratios on a monthly and quarterly basis, respectively. The Company was in compliance with all these covenants as at December 31, 2013.

29. RELATED PARTY TRANSACTIONS

a) Transactions with Key Management Personnel

Tim Lukenda, Extendicare's President and Chief Executive Officer, is the former President of Tendercare (Michigan) Inc. (Tendercare), a company acquired by EHSI in 2007, in which Mr. Lukenda owned an approximate 4.6% direct and indirect interest. Mr. Lukenda's employment contract provides a mechanism and process that effectively removes him from the decision-making process in situations where a conflict of interest may arise on any matter between the Company and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with the Company.

In connection with the purchase of Tendercare, the acquired working capital was subject to annual adjustments over a four-year period. The final working capital adjustment was paid in the third quarter of 2012, bringing EHSI's total payments to US$5.5 million.

In 2008, ECI acquired LTC Professional Insurance Company, Ltd., Tendercare's affiliated insurance company, for a nominal amount. Consideration for the acquisition was adjusted for annually based upon the actuarial liabilities determined at the end of each year through to 2012. The final adjusting payment of US$0.5 million was made in March 2013, bringing the total adjustments to US$5.6 million.

In July 2013, ECI sold one of its closed centers for $1.2 million to a company owned by members of Mr. Lukenda's family, of which Mr. Lukenda owns an approximate 7.1% direct and indirect interest.

In addition, with respect to other long-term care centers that are partly owned by Mr. Lukenda and his immediate family, ECI provides certain management services to a long-term care center in Ontario, Canada, and prior to April 2013, ECI operated under lease arrangements, a second long-term care center in Ontario. In addition, EHSI operates under lease arrangements, a skilled nursing center in Michigan, and until August 2013, EHSI provided certain management services to an assisted living center in Michigan.

b) Compensation of Key Management Personnel

The remuneration of directors and other key management personnel of the Company during the years ended December 31, 2013 and 2012, was as follows:

	2013	2012
Short-term benefits	**4,040**	4,257
Post-employment benefits	**221**	213
Share appreciation rights	**(26)**	(77)
	4,235	4,393

30. SEGMENTED INFORMATION

The Company has two reportable operating segments: United States operations and Canadian operations. These operations are managed independently of each other because of their geographic areas and regulatory environments. Each operation retains its own management team and is responsible for compiling its own financial information.

Through its subsidiaries, Extendicare operates long-term care centers in the United States and Canada. Also offered in the United States are medical specialty services, such as post-acute care and rehabilitative therapy services, as well as health technology services, while home health care services are provided in Canada.

Intersegment adjustments in the following tables reflect the reversal of intercompany amounts that are eliminated prior to the preparation of the Company's consolidated financial statements.

	United States	Canada	Eliminations	Total
Total Assets				
2013	1,325,870	525,424	(2,206)	1,849,088
2012	1,299,540	508,571	(195)	1,807,916
Total Liabilities				
2013	1,054,825	758,603	(2,206)	1,811,222
2012	1,027,261	726,190	(195)	1,753,256
Total Capital Expenditures				
2013	28,485	28,500	–	56,985
2012	31,930	53,046	–	84,976

				2013
	United States	Canada	Eliminations	Total
CONTINUING OPERATIONS				
Revenue				
Nursing and assisted living centers	1,216,569	568,870	–	1,785,439
Home health care	–	174,087	–	174,087
Health technology services	22,348	–	–	22,348
Outpatient therapy	13,360	–	–	13,360
Rent, management, consulting and other services	19,227	10,004	–	29,231
Total revenue	1,271,504	752,961	–	2,024,465
Operating expenses	1,137,620	655,748	–	1,793,368
Administrative costs	43,500	20,758	–	64,258
Lease costs	6,599	4,497	–	11,096
Total expenses	1,187,719	681,003	–	1,868,722
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items	83,785	71,958	–	155,743
Depreciation and amortization	59,395	18,534	–	77,929
Loss from asset impairment, disposals and other items	7,678	1,963	–	9,641
Earnings before net finance costs and income taxes	16,712	51,461	–	68,173
Interest expense	29,004	34,412	–	63,416
Accretion of decommissioning provisions	1,474	349	–	1,823
Other accretion	883	674	–	1,557
Loss on foreign exchange and financial instruments	–	519	–	519
Finance costs	31,361	35,954	–	67,315
Interest revenue	467	4,171	–	4,638
Fair value adjustments	–	3,099	–	3,099
Finance income	467	7,270	–	7,737
Net finance costs	30,894	28,684	–	59,578
Earnings (loss) before income taxes	(14,182)	22,777	–	8,595
Income tax expense (recovery)				
Current	3,295	1,252	–	4,547
Deferred	(6,311)	5,107	–	(1,204)
Total income tax expense	(3,016)	6,359	–	3,343
Net earnings (loss)	(11,166)	16,418	–	5,252

				2012
	United States	Canada	Eliminations	Total
CONTINUING OPERATIONS				
Revenue				
Nursing and assisted living centers	1,259,858	550,302	–	1,810,160
Home health care	–	170,343	–	170,343
Health technology services	25,453	–	–	25,453
Outpatient therapy	13,229	–	–	13,229
Rent, management, consulting and other services	9,912	8,316	–	18,228
Total revenue	1,308,452	728,961	–	2,037,413
Operating expenses	1,147,034	632,985	–	1,780,019
Administrative costs	43,923	19,232	–	63,155
Lease costs	6,465	4,521	–	10,986
Total expenses	1,197,422	656,738	–	1,854,160
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items	111,030	72,223	–	183,253
Depreciation and amortization	58,414	18,391	–	76,805
Loss from asset impairment, disposals and other items	4,656	3,274	–	7,930
Earnings before net finance costs and income taxes	47,960	50,558	–	98,518
Interest expense	32,598	32,708	–	65,306
Accretion of decommissioning provisions	1,334	360	–	1,694
Other accretion	427	181	–	608
Loss on foreign exchange and financial instruments	–	1,103	–	1,103
Finance costs	34,359	34,352	–	68,711
Interest revenue	402	3,163	–	3,565
Fair value adjustments	–	4,823	–	4,823
Finance income	402	7,986	–	8,388
Net finance costs	33,957	26,366	–	60,323
Earnings before income taxes	14,003	24,192	–	38,195
Income tax expense				
Current	2,913	2,265	–	5,178
Deferred	3,171	2,223	–	5,394
Total income tax expense	6,084	4,488	–	10,572
Earnings from continuing operations	7,919	19,704	–	27,623
DISCONTINUED OPERATIONS				
Earnings from discontinued operations, net of income taxes	35,033	–	–	35,033
Net earnings	42,952	19,704	–	62,656

31. SIGNIFICANT SUBSIDIARIES

The following is a list of the significant subsidiaries as at December 31, 2013, all of which are 100% directly or indirectly owned by the Company.

	Jurisdiction of Incorportion
Extendicare (Canada) Inc.	Canada
Extendicare Health Services, Inc.	Delaware
Extendicare Health Facilities, Inc.	Wisconsin
Extendicare Homes, Inc.	Delaware
Fir Lane Terrace Convalescent Center, Inc.	Washington
Indiana Health and Rehabilitation Centers Partnership	Delaware
Laurier Indemnity Company, Ltd.	Bermuda
Marshall Properties Inc.	Indiana
Northern Health Facilities, Inc.	Delaware
Tendercare (Michigan) Inc.	Michigan

Corporate Governance

Extendicare's Board of Directors and management team fully acknowledge the importance of their duty to serve the long-term interests of shareholders.

Extendicare believes that good corporate governance is fundamental for the effective operation of the organization and for maintaining the confidence of investors and increasing shareholder value.

Our governance system is built on the values of trust, transparency and high standards of corporate ethics, and we are committed to the principles of disclosure and a strong, independent board. Our commitment to providing quality services, while building shareholder value, is the basis for a well-established and enduring organization.

Extendicare is dedicated to providing timely, accurate and complete disclosure of all material information to the public. Our Board of Directors and Committee members operate under Charters that clearly define their roles and responsibilities, including: Stewardship, Independence, Effectiveness and Accountability.

Further information on the directors of Extendicare and a description of Extendicare's governance practices may be found in Extendicare's Management Information and Proxy Circular as filed with SEDAR at www.sedar.com and on Extendicare's website at www.extendicare.com.

The Board of Directors of Extendicare

Benjamin J. Hutzel [A, HR/GN, QC]
Chairman

Timothy L. Lukenda
President and Chief Executive Officer

John F. Angus [A]
Senior Partner of PerformaCorp Inc.

Margery Cunningham [A]
Vice President, Avalere Health LLC

Governor Howard B. Dean, MD [HR/GN, QC]
Senior Strategic Advisor and Independent Consultant,
McKenna Long & Aldridge LLP, and former Governor of Vermont

Dr. Seth B. Goldsmith [A, QC]
Attorney and Professor Emeritus,
University of Massachusetts at Amherst

Alvin G. Libin [HR/GN]
President and Chief Executive Officer of Balmon Investments Ltd.

J. Thomas MacQuarrie, Q.C. [A]
Senior Partner in the Atlantic Canada law firm of Stewart McKelvey

Honorary Directors
Mel Rhinelander
Retired Chairman and Chief Executive Officer of Extendicare

Frederick B. Ladly
Retired Chairman and Chief Executive Officer of Extendicare

George A. Fierheller
President of Four Halls Inc.

Michael J. L. Kirby
Founding Chair of Partners for Mental Health

A	Audit Committee
HR/GN	Human Resources, Governance and Nominating Committee
QC	Quality and Compliance Committee

Officers and Executives

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Chairman

Timothy L. Lukenda
President and Chief Executive Officer

Paul Tuttle
President of Canadian Operations

Dylan T. Mann
Senior Vice President and
Chief Financial Officer

Jillian E. Fountain
Corporate Secretary

Elaine E. Everson
Vice President and Controller

Extendicare Health Services, Inc.

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Milwaukee, Wisconsin, U.S.A.
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Tel: (800) 395-5000
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Timothy L. Lukenda
Chairman and Chief Executive Officer

Richard Gurka
Senior Vice President, Operations

Dylan T. Mann
Senior Vice President,
Chief Financial Officer and Treasurer

Jillian E. Fountain
Corporate Secretary

William Bryan
Vice President, Design & Development

Timothy Detary
Vice President, Human Resources

Dr. John Hackett
Vice President of Strategy and Development

David Keating
Vice President and General Counsel

Donna J. Thiel
Vice President and Chief Compliance Officer

LaRae L. Nelson
Vice President, Reimbursement

Judith Taubenheim
Vice President, Clinical Services

Extendicare (Canada) Inc.

3000 Steeles Avenue East, Suite 700
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Chairman and Chief Executive Officer

Paul Tuttle
President

Dylan T. Mann
Senior Vice President and
Chief Financial Officer

Jillian E. Fountain
Corporate Secretary

Deborah Bakti
Vice President, Human Resources

Elaine E. Everson
Vice President and Controller

Gary M. Loder
Vice President of Managed Homes
and Consulting

Richard Luneburg
Vice President, Western Operations

Christina L. McKey
Vice President, Eastern Operations

A. Paula Neves
Vice President of Quality and
Healthcare Innovation

Five-year Summary[1]

(unaudited) (thousands of dollars unless otherwise noted)	**2013**	2012	2011	2010	2009
Financial Position					
Property and equipment	**1,152,007**	1,181,596	1,192,913	1,206,656	863,430
Total assets	**1,849,088**	1,807,916	1,830,704	1,994,634	1,668,065
Long-term debt, including current portion	**1,164,836**	1,132,235	1,134,440	1,241,196	1,234,032
Shareholders'/unitholders' equity (deficiency)	**37,866**	54,660	48,319	112,994	(40,903)
Financial Results					
Revenue					
Nursing and assisted living centers					
United States	**1,216,569**	1,259,858	1,355,289	1,397,452	1,463,497
Canada	**568,870**	550,302	525,831	495,610	479,125
Home health care – Canada	**174,087**	170,343	165,030	157,177	155,096
Health technology services – United States	**22,348**	25,453	19,120	17,205	18,853
Outpatient therapy – United States	**13,360**	13,229	13,750	12,603	13,905
Rent, management, consulting and other services	**29,231**	18,228	15,062	17,369	31,091
	2,024,465	2,037,413	2,094,082	2,097,416	2,161,567
EBITDA[2]	**155,743**	183,253	200,136	242,070	265,670
Earnings from continuing operations before separately reported items[2]	**10,334**	29,532	6,986	39,378	59,165
Net earnings (loss)	**5,252**	62,656	(30,396)	41,829	77,708
AFFO[2]	**71,114**	84,569	69,847	110,736	146,137
AFFO per basic share/unit *($)*	**0.82**	0.99	0.84	1.36	2.00
Distributions declared per share/unit *($)*	**0.60**	0.84	0.84	0.84	0.84
Distribution payout ratio *(% of AFFO)*	**73**	85	100	62	42
Average U.S./Canadian dollar exchange rate	**1.0299**	0.9996	0.9891	1.0299	1.1420
Other Information					
Number of centers operated *(year end)*					
United States	**156**	158	179	181	176
Canada	**93**	88	82	85	82
	249	246	261	266	258
Operational resident capacity *(year end)*					
United States	**15,207**	15,361	17,369	17,658	17,295
Canada	**12,479**	11,467	10,738	11,789	11,523
	27,686	26,828	28,107	29,447	28,818
U.S. nursing center average daily census by payor source *(%)*					
Medicare	**15.6**	15.8	16.8	16.4	16.2
Managed Care	**6.5**	6.0	6.0	5.7	5.7
Skilled Mix	**22.1**	21.8	22.8	22.1	21.9
Private/other	**10.5**	10.1	9.9	10.5	10.7
Medicaid	**67.4**	68.1	67.3	67.4	67.4
U.S. nursing center revenue by payor source *(%)*					
Medicare	**29.7**	31.0	34.9	33.3	32.9
Managed Care	**10.7**	10.1	10.0	9.5	9.6
Skilled Mix	**40.4**	41.1	44.9	42.8	42.5
Private/other	**9.6**	9.2	8.5	9.2	9.3
Medicaid	**50.0**	49.7	46.6	48.0	48.2
Average occupancy – U.S. nursing centers *(%)*	**82.9**	85.2	85.7	86.0	87.9
Average occupancy – Canadian centers *(%)*	**97.7**	98.0	96.9	98.0	98.1
ParaMed home health care hours of service	**4,911,000**	4,796,000	4,634,000	4,402,000	4,554,000
Number of employees *(year end)*	**35,300**	35,700	38,100	37,700	38,000
Number of shares/units outstanding *(year end)*	**87,266,511**	85,989,376	84,121,488	82,995,181	73,180,024

(1) The selected information presented for 2009 was prepared under previous Canadian GAAP and has not been restated for discontinued operations identified in 2011 under IFRS.

(2) Refer to discussion of non-GAAP measures on page 58.

Securityholder Information

Extendicare Inc.

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Transfer Agent

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email: service@computershare.com

www.computershare.com

Exchange Listings/ Trading Profile

Toronto Stock Exchange Symbols
Common shares: EXE
Convertible debentures: EXE.DB and EXE.DB.B

2013 EXE Common Share Activity
High: $8.79; Low: $5.12
Close: $6.82; Volume: 62,318,745

Shareholder Inquiries/ Investor Relations

Jillian Fountain
Corporate Secretary

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email: jfountain@extendicare.com

Annual Meeting

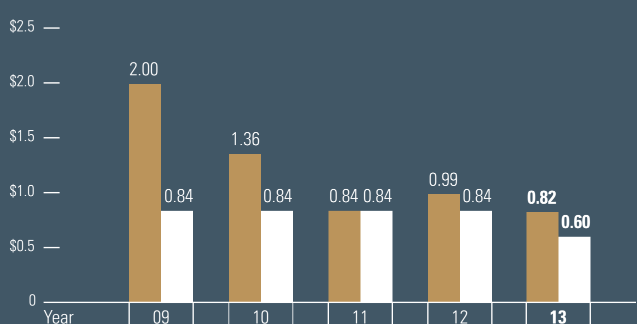
Shareholders are invited to attend the Annual Meeting of Extendicare Inc. on May 7, 2014, at 2:30 p.m., at the Toronto Board of Trade, 1 First Canadian Place, Toronto, Ontario, Canada

Published Information

Extendicare Inc.'s 2013 Annual Report is available for viewing or printing on its website at www.extendicare.com, together with news releases, quarterly reports and other filings with the securities commissions. Printed copies of the annual report are available upon request to the Corporate Secretary.

Extendicare AFFO and Cash Distributions[1]

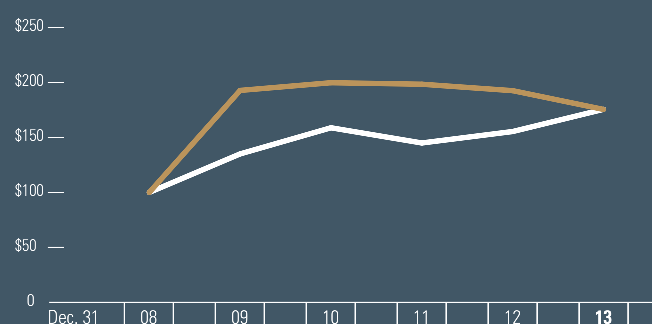
AFFO *($ per basic share/unit)*
Cash distributions *($ per share/unit)*



Payout ratio: 42% 62% 100% 85% 73%

(1) The AFFO for 2009 was prepared under previous Canadian GAAP.

Relative Share Price Performance
(assuming a $100 investment is made at December 31, 2008)
Extendicare — S&P/TSX Composite



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