EXTENDICARE®

... helping people live better

Delivering Value

2012 Annual Report

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 35,700 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 246 senior care centers in Canada and the United States have capacity to care for approximately 26,800 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.

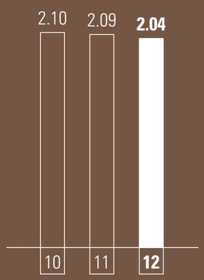
The Company is the successor to Extendicare Real Estate Investment Trust ("Extendicare REIT" or the "REIT") following the conversion of the REIT from an income trust structure to a corporate structure on July 1, 2012 (the "2012 Conversion"). The 2012 Conversion was accounted for as a continuity of interest, and accordingly, the consolidated financial information of the Company is reflective as if Extendicare had always carried on the business previously carried on indirectly by Extendicare REIT.

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

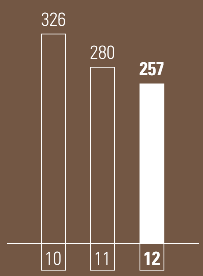
Financial Highlights

(millions of dollars unless otherwise noted)	**2012**	2011	2010
Balance Sheet			
Cash and short-term investments	**71.4**	80.0	267.8
Long-term debt, including current portion	**1,132.2**	1,134.4	1,241.2
Total assets	**1,807.9**	1,830.7	1,994.6
Shareholder Information[1]			
Funds from operations (FFO)	**88.6**	63.4	108.1
FFO *($ per basic share/unit)*	**1.04**	0.76	1.33
Adjusted funds from operations (AFFO)	**84.6**	69.8	110.7
AFFO *($ per basic share/unit)*	**0.99**	0.84	1.36
Distributions declared	**71.5**	70.1	68.8
Distributions declared *($ per basic share/unit)*	**0.84**	0.84	0.84
Weighed average shares/units – Basic *(thousands)*	**85,039**	83,408	81,533
– Fully diluted *(thousands)*	**100,420**	97,205	95,346

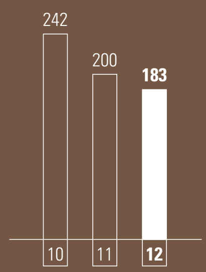
Revenue
(in billions of dollars)



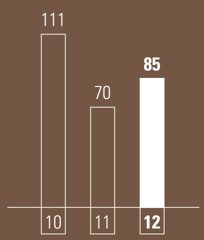
Net Operating Income[1]
(in millions of dollars)



EBITDA[1]
(in millions of dollars)



AFFO[1]
(in millions of dollars)



(1) Refer to non-GAAP measures on page 62.

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 8 for a caution to the reader on the reliance of such statements.

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.

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Timothy L. Lukenda
President & Chief Executive Officer

CEO's Message

Fellow Shareholders,

In 2012, Extendicare continued to build a strong, stable financial platform for our Company. This was accomplished in spite of the current uncertainty in the U.S. health care sector, persisting weakness in the economy, and a challenging U.S. litigation and regulatory environment. Throughout this uncertain period we have endeavoured to chart a steady course by focusing on our delivery of quality care and services to residents in our centers across North America and managing our operations efficiently and cost effectively.

Highlights of the Year

This year, Extendicare substantially concluded the refinancing of approximately US$636 million of long-term debt with approximately US$510 million in mortgages insured by the U.S. Department of Housing and Urban Development (HUD) and US$126 million of cash on hand. Collectively, the weighted average all-in interest rate of the HUD loans is 4.33%, with an average term to maturity of 33 years. This successfully concludes an intense process initiated in 2010 to create a solid financial foundation for the Company. The refinancing is a key strategic asset because of the enduring financial strength and flexibility that it provides us. Together with the $72.4 million mortgage refinancing that we completed on our Canadian operations at the end of 2011, the combined annualized interest savings from these transactions is an estimated $25 million.

In September, Extendicare completed a $126.5 million bought deal public offering of 6.00% convertible unsecured debentures due September 30, 2019, of which $94.0 million of the net proceeds were used to redeem our 7.25% convertible unsecured debentures that were due in June 2013.

In addition, we finalized the leasing of all 21 of our skilled nursing centers in the State of Kentucky to a third-party operator, thereby achieving our planned exit as a result of the heightened litigation environment that currently exists in the state. The decision to exit Kentucky operations was a prudent step for the Company to take in the interest of our shareholders and is consistent with our ongoing strategy of conservative risk management and continuous performance improvement.

U.S. Operations

Extendicare is one of the largest long-term care providers in the United States, and is ranked as the eighth largest operator of nursing center beds according to *Provider Magazine* (June 2012 edition). Our skilled nursing centers across the country are focused on providing quality, person-centered care to residents. In 2012, our Company was again recognized for outstanding performance in the U.S. health care profession, winning two of the prestigious American Health Care Association and National Centers for Assisted Living's (AHCA/NCAL) *Silver – Achievement in Quality* awards. The two health centers so recognized were Tendercare Mt. Pleasant Health and Rehab Center in Mt. Pleasant, Michigan and Cedar Springs Health and Rehabilitation Center in Cedarburg, Wisconsin. These centers were two of only 55 centers nationwide to receive this award this year. In addition, 17 of our health centers received the AHCA/NCAL's *Bronze – Commitment to Quality* awards in recognition of their strong commitment to continuous quality improvement. With these 2012 awards, over 60% of our skilled nursing centers have received either Bronze or Silver awards from the AHCA/NCAL.

Within the North American health care continuum, Extendicare is a leading low-cost, quality health care service provider best able to meet the specific needs of individuals who need skilled nursing care or rehabilitation in the short term.

Extendicare's commitment to continuous quality improvement is also recognized through the U.S. Five-Star Quality Rating System, introduced by the Centers for Medicare and Medicaid Services (CMS) in 2009 to help consumers better select health centers that best meet their needs. Since the inception of the Five-Star Quality Rating System, almost 60% of our centers have improved their individual rating with over 36% now achieving a four-star or five-star rating, up from 9% five years ago. Strategies to improve ratings include continuing education and training, and ensuring that staffing levels are optimized for changes in acuity mix and improving the documentation of care provided.

Canadian Operations

Extendicare's Canadian operations remain strong, with leadership positions in both the nursing home and home care sectors of Canada's health care industry. Extendicare is the second largest private sector operator of long-term care homes in Canada, based on the number of beds available. The majority of our nursing homes are in Ontario where we have close to a 10% market share. Also, we are currently the largest home health care operator in Ontario with a market share of approximately 15% based on the hours of service provided. We anticipate this will increase as we continue to grow. This year, our Canadian operations EBITDA margin improved to 9.9% from 9.4% in 2011. The average daily revenue rate on a same-facility basis increased by 2.0% over 2011 and our occupancy rates remained unchanged at a solid 98%. In addition, we significantly increased our managed contract business, which is a growing line of business for the Company in Canada.

On the development side, we continue to make strategic investments to grow our operations. At the end of 2011, we opened a new state-of-the-art 180-bed nursing center in Edmonton, Alberta and two Ontario projects are currently under way in Sault Ste. Marie and Timmins that will open later this year. The Northern Ontario projects will replace existing centers we operate in those locations and once they are fully operational, we expect they will generate incremental EBITDA of approximately $1.8 million.

Extendicare continues to leverage its expertise in managing long-term care centers by developing health care partnership arrangements with public, private and not-for-profit organizations. Through our Extendicare Assist division in Canada, we focus on acquiring new managed care partnerships and consulting opportunities. During the year, we continued to grow our managed care portfolio with the addition of six centers, bringing the total to 28.

Current Challenges

In 2012, Extendicare experienced disappointing financial results with declines in revenue and EBITDA due to the persisting weakness in the U.S. economy, the impact of cuts to Medicare funding following the October 2011 implementation of the CMS Final Rule, and the need to strengthen our reserves for self-insured general and professional liabilities.

For the year, Extendicare's revenue and EBITDA was $2,037.4 million and $183.2 million, respectively, and excluding the positive effect of foreign exchange, declined over the prior year by 3.4% and 9.0%, respectively. Excluding the increase in prior years' reserves for self-insured liabilities, EBITDA declined by $44.5 million, or 18.3% over 2011, with a margin of 9.8% this year compared to 11.6% in 2011. This decline was primarily due to the reduction in U.S. funding and lower U.S. census levels.

Medicare Funding Updates

In October, CMS set the net market basket increase at 1.8%, providing the Company with additional Medicare revenue of approximately US$6.0 million per year. However, a planned reduction in our Medicare rates of 2% will occur on April 1, 2013, as a result of sequestration.

Self-insured Liability Reserves

Following the independent actuarial reviews of our self-insured general and professional liabilities that are conducted three times a year, it was necessary to strengthen our prior years' reserves by US$16.6 million this year compared to the US$43.3 million recorded in 2011. The continued strengthening of our prior years' reserves

Tendercare Mt. Pleasant Health and Rehab Center in Mt. Pleasant, Michigan and Cedar Springs Health and Rehabilitation Center in Cedarburg, Wisconsin were two of only 55 centers nationwide to receive the AHCA/NCAL's *Silver – Achievement in Quality* award in 2012.

was primarily attributable to claims in the State of Kentucky and settlement of certain pre-2012 claims in other states.

Based on current claims activity levels, I believe that we are making the provisions necessary to address our current exposure. This is a key priority for us and 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 in the future.

Future Outlook

This is a challenging time for our Company and our industry, particularly in the U.S. In the face of the continued weakness of our business environment, our management team has acted effectively to adapt to these new realities. We have taken steps to put operational and organizational efficiencies in place to keep us focused on our core business and objective – delivering quality care to residents of our centers across North America.

As a result of the steps we have taken this year, I believe we are well positioned to capitalize on our inherent strengths and grow our market presence when the business environment and funding picture improves. Our society is changing. Demographically speaking, people are living longer than in the past and the senior care sector is growing significantly. As governments seek to fulfill their growing obligations to this sector of the population within their fiscal constraints, our value proposition as a health care service provider has never been more clear.

Within the North American health care continuum, Extendicare is a leading low-cost, quality health care service provider best able to meet the specific needs of individuals who need skilled nursing care or rehabilitation in the short term. We are always looking at new opportunities to improve our service offering in light of this trend, by embracing new clinical technologies, investigating lifestyle innovations and introducing more sophisticated programs to our health care delivery that will enhance our offering to customers and alignment with health care partners.

Looking ahead, we are committed to building on our financial strength, stability and dedication to quality to seize new opportunities for growth in our core business, as well as considering new markets where our platform offers a strategic advantage.

I would like to thank our Extendicare customers for their loyalty, our team members for their hard work and commitment, our shareholders for their continued support and the Board of Directors for their invaluable counsel and support.

(signed)

Timothy L. Lukenda
President & Chief Executive Officer

Mission, Vision, Values

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 40 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

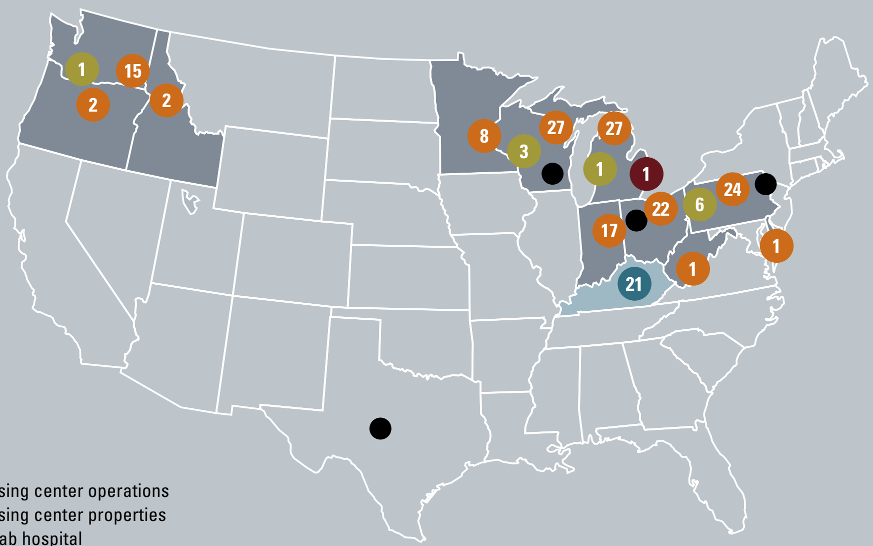
At Extendicare, we value our customers and our team who cares for them. We are committed to treating them with dignity and respect in an atmosphere of compassion. As health care professionals, we take pride in being responsive to the needs of those who rely on us.

Respect • Integrity • Pride • Compassion • Responsiveness • Dignity

Operations Overview

Extendicare is dedicated to providing quality services to residents and patients who entrust us with their health and dignity to help them live better.

U.S. Operations



- Nursing center operations
- Nursing center properties
- Rehab hospital
- Assisted living & retirement centers
- ProStep outpatient rehab (24 clinics)

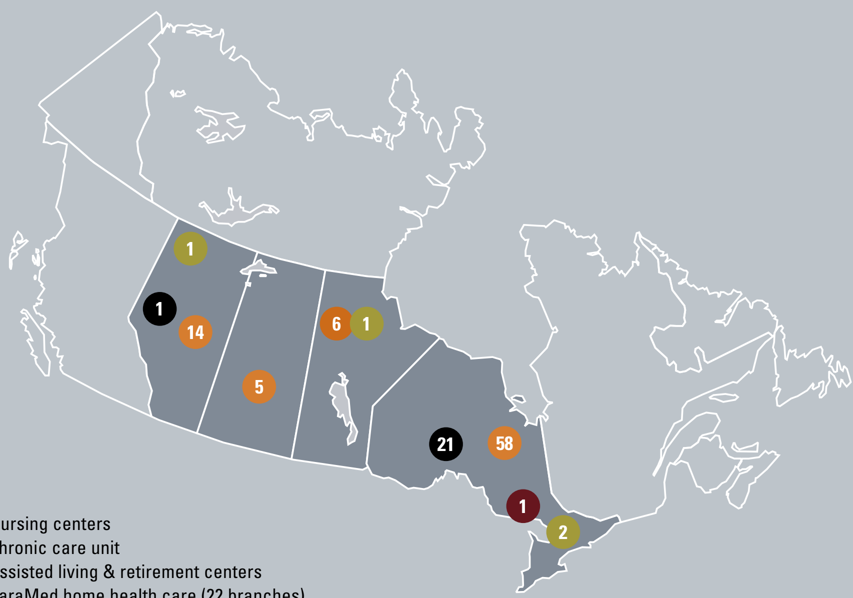
158	15,361	32%	50%
centers operated in 11 states	beds	quality mix census	quality mix revenue

- U.S. government funding reductions and changes in therapy services, which adversely impacted Medicare Part A and Managed Care rates, together with the successful leasing out of the Company's Kentucky operations, reduced revenue:
  - Revenue decreased by 7.2% to US$1,309.0 million
  - Medicare Part A rates decreased by 8.4% to US$461
  - Managed Care rates decreased by 2.4% to US$432
- Sold our U.S. group purchasing operations for US$56.0 million in January 2012
- Successfully leased our Kentucky operations (21 centers) to a third party in 2012
- During 2012, two of our centers were awarded the AHCA/NCAL's *Silver – Achievement in Quality* award, and 17 were awarded the AHCA/NCAL's *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 consolidated continuing operations for 2012, our U.S. operations represented approximately 64% of revenue and 61% of EBITDA. EHSI is focused on providing quality, person-centered care to residents. A total of 91 of our U.S. centers have been recognized for their commitment to quality (Bronze awards), and three of those have been further acknowledged for their achievement in quality (Silver awards), by the American Health Care Association.

Canadian Operations



- Nursing centers
- Chronic care unit
- Assisted living & retirement centers
- ParaMed home health care (22 branches)

88	11,467	72%	98%
centers in 4 provinces	beds	of resident capacity in Ontario	occupancy

- Revenue increased by 4.4% to $728.9 million primarily from funding increases and newly constructed centers that opened in 2010 and 2011
- Managed portfolio increased by six centers to 28 during 2012
- Two new state-of-the-art centers under construction in Ontario to open in 2013
  - 256-bed nursing center in Sault Ste. Marie (April 2013)
  - 180-bed nursing center in Timmins (July 2013)

Overview

Extendicare's Canadian Operations are conducted through its wholly owned subsidiary, Extendicare (Canada) Inc. (ECI). As a percentage of consolidated continuing operations for 2012, our Canadian operations represented approximately 36% of revenue and 39% of EBITDA. Our average same-facility occupancy levels remained consistently close to full capacity in 2012. 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.

Success means empowering team members to live our vision of excellence – recognizing our people are our greatest strength and striving to create compassionate and rewarding work environments.

Financial Review

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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. Forward-looking statements can be identified by the expressions "anticipate", "believe", "estimate", "expect", "intend", "objective", "plan", "project" or other similar expressions or the negative thereof. These forward-looking statements reflect the Company's current expectations regarding future results, performance or achievements and are based upon information currently available to the Company and on assumptions that the Company believes are reasonable.

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 exposure of the Company to punitive damage claims, including the associated 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.

Management's Discussion and Analysis

March 20, 2013

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. Additional information on the 2012 Conversion can be found under the heading "Overview – Significant 2012 Events and Developments – 2012 Corporate Conversion".

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, 2012. This MD&A should be read in conjunction with Extendicare's audited consolidated financial statements for the years ended 2012 and 2011, and the notes thereto, found in Extendicare's 2012 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 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. 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 2012 and 2011, 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, 2012, or December 31 of the year referenced.

The discussion and analysis in this MD&A is based upon information available to management as of March 20, 2013. 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;
- 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.

Effective October 1, 2011, the U.S. Centers for Medicare & Medicaid Services (CMS) implemented reductions in Medicare funding to skilled nursing centers along with other changes (the "2011 CMS Final Rule"), which we estimate has adversely impacted our revenue and earnings from operations before net finance costs, income taxes, depreciation and amortization (EBITDA) by approximately US$64 million on an annualized basis. In light of the 2011 CMS Final Rule, and the uncertainty surrounding further potential Medicare and Medicaid funding reductions, management implemented aggressive cost saving measures to reduce operating and administrative costs by an estimated US$24 million on an annualized basis. Therefore, we estimate that the net negative effect of the 2011 CMS Final Rule on our EBITDA, partially offset by our cost saving initiatives, is approximately US$40 million on an annualized basis. For more information on recent Medicare and Medicaid funding changes and our mitigation strategies, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

During 2011 and 2012, Extendicare strengthened its balance sheet by refinancing a significant portion of its long-term debt with government insured mortgages at lower rates and longer terms to maturity. By the end of 2012, we had closed on US$506.3 million of mortgages insured by the U.S. Department of Housing and Urban Development Program (HUD) to refinance debt in our U.S. operations, US$497.7 million of which had been completed by the end of the 2012 first quarter. As well, in December 2011, we refinanced $72.4 million of mortgages in our Canadian operations with new Canadian Mortgage and Housing Corporation (CMHC) mortgages with maturity dates of 2017 and 2022. We estimate that the savings in annual debt service costs to Extendicare from these refinancings will be approximately $25 million. Furthermore, we successfully entered into a new US$100.0 million credit facility (the "EHSI Credit Facility") in 2012 upon maturity of our US$70.0 million line of credit. For more information on these debt refinancings, refer to the discussion under the headings "2011/2012 Refinancing Plan" and "EHSI Credit Facility" under the heading "Overview – Significant 2012 Events and Developments".

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. While the U.S. funding reductions will have real consequences in the way we operate our business, we are confident that our efforts, combined with our strategic marketing initiatives, will enable us to be successful in this environment.

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 246 senior care centers with capacity for 26,828 residents at December 31, 2012. In addition, we own 21 centers (1,762 beds) in the State of Kentucky that are leased to a third-party operator. The transfer of 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 "Significant 2012 Events and Developments – 2012 Kentucky Lease Transaction".

Extendicare's wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates 158 senior care centers with capacity for 15,361 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 88 senior care centers, with capacity for 11,467 residents. ECI has a significant presence in Ontario and Alberta, where approximately 72% and 14% of its residents are served, respectively. Also, through its ParaMed Home Health Care (ParaMed) division, ECI is a major provider of home health care in Ontario and Alberta.

Extendicare owns rather than leases a majority of its properties, unlike a number of other long-term care providers. At December 31, 2012, we operated 201 centers that we either owned or leased with options to purchase, representing approximately 98% of our 206 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, 2012. 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		Rehab Hospital/ 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	14,035	4	270	1	28	143	14,333
Leased	4	419	–	–	–	–	4	419
Managed	4	399	7	210	–	–	11	609
Total	146	14,853	11	480	1	28	158	15,361
Canada								
Owned	48	6,545	1	200	–	–	49	6,745
Leased(1)	10	1,250	–	76	–	–	10	1,326
Managed	25	2,991	3	285	1	120	29	3,396
Total	83	10,786	4	561	1	120	88	11,467
Total	**229**	**25,639**	**15**	**1,041**	**2**	**148**	**246**	**26,828**

(1) Nine of the ten 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 the 2012 and the 2011 years.

Extendicare Senior Care Centers	2012 No. of Centers	2012 Operational Beds/Units	2011 No. of Centers	2011 Operational Beds/Units
As at beginning of the year	**261**	**28,107**	266	29,447
Development (owned and leased)(1)	–	–	3	500
Managed contracts added	**6**	**738**	6	349
Managed contracts matured(2)	–	–	(11)	(1,765)
Closed(3)	–	–	(2)	(175)
Divested/leased to third party(4)	**(21)**	**(1,762)**	(1)	(92)
Operational capacity adjustments(5)	–	**(255)**	–	(157)
As at the end of the year	**246**	**26,828**	261	28,107

(1) 2011 activity: In January we opened a 140-unit designated assisted living unit in Lethbridge, Alberta, and a 120-bed skilled nursing center in Lansing, Michigan. In February and November, we opened the 60 designated assisted living units of our Red Deer center, and the 180-bed nursing center in Edmonton, Alberta, respectively.

(2) The 11 matured managed contracts during 2011 related primarily to eight centers that had been managed by ECI under a bankruptcy action that were sold to a third party effective January 1, 2011.

(3) The closed nursing centers relate to our Lethbridge and Edmonton, Alberta nursing centers that closed upon the opening of our new centers in the region.

(4) The 2012 activity relates to the Kentucky lease transaction, as discussed under the heading "Significant 2012 Events and Developments – 2012 Kentucky Lease Transaction". The 2011 activity relates to the sale of a skilled nursing center in Michigan.

(5) 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 2012 Events and Developments

This section summarizes the impact of the following items on the operations of Extendicare: the 2012 corporate conversion; the 2012 Medicare update; the 2012 Kentucky lease transaction; the provision for self-insured liabilities; the 2011/2012 refinancing plan; the EHSI Credit Facility; and the 2011 CMS Final Rule. Refer to the discussion under the heading "Other Significant Developments" for a summary of other developments affecting the financial results or operations of Extendicare.

2012 CORPORATE CONVERSION

At a special meeting held on May 8, 2012, Extendicare REIT received 97.72% approval from its holders of trust 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 trust units of the REIT (the "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 then outstanding 5.70% convertible unsecured subordinated debentures due June 30, 2014, and 7.25% convertible unsecured subordinated debentures due June 30, 2013 (collectively, the "Convertible Debentures"). As a result, holders of the 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 Convertible Debentures due June 30, 2014, and June 30, 2013, continued trading on the TSX under the trading symbols "EXE.DB" and "EXE.DB.A", respectively. Further details relating to the 2012 Conversion are contained in the REIT's Management Information and Proxy Circular dated April 2, 2012.

There were no changes resulting from the 2012 Conversion to the members of the board of directors (the "Board of Directors" or the "Board") or to senior management of Extendicare.

Extendicare REIT had been subject to tax applicable to specified investment flow-through trusts since 2007 at tax rates that were comparable to the general corporate tax rate applicable to Canadian corporations. Consequently, the 2012 Conversion itself did not impact the funds available for distribution by Extendicare to its shareholders.

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, future financial prospects and debt covenants, as well as other factors that may be considered to be relevant by the Board. Extendicare's distribution payout ratio was approximately 85% in 2012 (2011 – 100%).

2012 MEDICARE UPDATE

As previously announced, the net market basket increase for October 2012 was 1.8%, which consisted of a market basket increase of 2.5% minus a productivity adjustment of 0.7%. We estimate that the impact of this 1.8% funding increase will provide us with additional Medicare revenue of approximately US$6.0 million per annum. However, as previously indicated, 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 have been delayed until April 1, 2013, by the signing into law of the *American Taxpayer Relief Act of 2012* (ATRA). A 2% funding reduction is estimated to reduce our Medicare revenue by approximately US$6.7 million per annum.

Effective October 2012, CMS established a requirement for pre-approval by a physician of claims over US$3,700 for physical and speech therapy and a second approval process for claims over US$3,700 for occupational therapy. Approval or denial of therapy services beyond these caps is determined on an individual basis and, therefore, the impact cannot be precisely determined. EHSI recorded negative revenue adjustments of US$1.0 million in the 2012 fourth quarter for denials of therapy services over the cap. The ATRA has extended these therapy cap requirements until December 31, 2013. The impact of these therapy caps may be mitigated to a certain extent by reductions in staffing and, in some cases, residents paying privately for these services.

In addition, the ATRA has delayed, until January 1, 2014, the implementation of cuts to the Medicare physician fee rates, which included a 27% reduction of Medicare Part B rates that were to have commenced on January 1, 2013. The impact of the 27% Part B rate reduction on EHSI's therapy revenue was estimated to be US$11 million per annum. We continue to dialogue with policymakers about the impact of the Part B rate reduction and therapy caps on access to care and quality of life for our residents.

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".

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 that involves the divestiture of operations that impede growth or create undue risk exposure. According to the *2012 AON Long Term Care General Liability and Professional Liability Actuarial Analysis*, the loss rate in Kentucky has increased from US$690 per bed in 2004 to US$4,930 per bed in 2011, and is projected to be US$5,120 per bed in 2012.

We have 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 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, Extendicare estimates that the lease transaction will reduce its EBITDA by approximately $3.2 million per annum and adjusted funds from operations (AFFO) by approximately $0.6 million or $0.007 per share per annum.

For further information, refer to *notes 6 and 17* of the 2012 consolidated financial statements.

PROVISION FOR SELF-INSURED LIABILITIES

The results of our independent actuarial review conducted at year end did not necessitate a further strengthening of reserves for our pre-2012 claims in the 2012 fourth quarter. For the year ended December 31, 2012, we have made provisions for self-insured liabilities of $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 has accounted for more than 50% of our provision for self-insured liabilities over the past two years. We had anticipated that following our exit from that state in mid-2012 our provision for self-insured liabilities would be reduced by approximately US$12 million per annum. However, an increase in claims in other states has offset this anticipated reduction.

For more information, refer to the discussion under the heading "Accrual for Self-insured Liabilities" under the "Liquidity and Capital Resources – Capital Structure" section.

2011/2012 REFINANCING PLAN

Issue of 2019 Convertible Debentures and Redemption of 2013 Convertible Debentures

As previously announced, 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 on October 29, 2012, to redeem all of Extendicare's outstanding 7.25% convertible unsecured subordinate debentures due June 2013 (the "2013 Debentures"). The redemption price of the 2013 Debentures was equal to the sum of the outstanding aggregate principal amount of $91,794,000 and all accrued and unpaid interest thereon for a total of $93,999,810, or $1,024.03 per $1,000 principal amount of 2013 Debentures.

The balance of the net proceeds will be used by Extendicare for general corporate purposes, which may include reducing indebtedness, funding internal growth expenditures or purchasing Common Shares under its normal course issuer bid.

U.S. Operations – HUD Mortgages

EHSI has substantially completed the refinancing of approximately US$636 million of debt with approximately US$510 million in HUD-insured mortgages and US$126 million of cash on hand. As at December 31, 2012, EHSI had closed on 68 HUD loans with a principal balance of US$506.3 million in connection with this refinancing. EHSI anticipates obtaining and closing on the one remaining HUD commitment with a principal balance of US$3.6 million by the end of the 2013 first quarter. Upon conclusion of this refinancing, EHSI anticipates it will have closed on approximately US$510 million in new HUD-insured mortgages with a weighted average rate of approximately 4.33%, inclusive of mortgage insurance premiums (MIP), and term to maturity of about 33 years. The annualized interest savings from the refinancing is estimated to be US$20 million.

The debt being refinanced related to EHSI's CMBS financings that were due in March 2012 (the "March 2012 CMBS Financing") and in May 2012 (the "May 2012 CMBS Financing"), mortgage financing from Sovereign Bank and other lenders (the "Sovereign Loans"), and approximately US$17.5 million of advances on the EHSI Credit Facility. The Sovereign Loans, March 2012 CMBS Financing and May 2012 CMBS Financing were fully repaid by the end of June 2011, November 2011 and February 2012, respectively.

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 October 2013. EHSI already had approximately US$27 million of HUD loans issued prior to refinancing of approximately US$510 million. EHSI is in the process of securing additional HUD loans to refinance existing debt that would result in utilizing approximately US$574 million of its US$585.0 million overall limit before it expires in October 2013. As at December 31, 2012, EHSI had approximately 55 unencumbered centers valued at an estimated US$250 million, none of which are part of the additional HUD financings yet to be completed.

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.

Canadian Operations – CMHC Mortgages

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% and due to mature in March 2013. The new debt 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 due in June 2013, pending new fixed-rate mortgages negotiated in 2012. 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.

During the 2012 first quarter, $8.7 million of the bridge loan for one of the centers was converted from a variable-rate mortgage to a fixed-rate mortgage at 3.15%, due March 2022, using the existing CMHC certificate. In July 2012, the $4.6 million bridge loan on the second center was converted to a fixed-rate mortgage under a new CMHC certificate in the amount of $10.8 million at 2.93%, due December 2022.

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 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 an 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 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. Whereas, the 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, 2012, we had drawn US$8.1 million on the EHSI Credit Facility and issued US$2.6 million under a letter of credit, leaving US$89.3 million available. 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, 2012 was 5.25% (December 31, 2011 – 6.43% under the former agreement).

For further information on the U.S. and Canadian refinancings, refer to *note 11* of the 2012 consolidated financial statements.

2011 CMS FINAL RULE

The 2011 CMS Final Rule that was effective October 1, 2011, included an 11.1% reduction in Medicare funding to skilled nursing centers along with the elimination of group therapy and changes in the assessment process. The impact of the 2011 CMS Final Rule was not fully realized in our 2011 fourth quarter results due to the transitional rules in place. Therefore, we experienced a further 1.6% decline in our average Medicare Part A rate in the 2012 first quarter from the 2011 fourth quarter levels. Our average daily revenue rates for Medicare Part A and Managed Care declined by 12.5% and 6.9%, respectively, in the 2012 first quarter from the 2011 third quarter levels. We estimate that the impact of the CMS Final Rule, prior to implementing cost saving measures, is a reduction of our 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.

Prior to October 1, 2011, we completed a thorough review of our operations and implemented a number of changes within our organization and secured vendor pricing concessions. These savings are anticipated to reduce our general, administrative and non-wage operating costs by an estimated 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 EBITDA, partially offset by our cost saving initiatives, is approximately US$40 million on an annualized basis.

For further details on the announced cuts and their estimated impact to us, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

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;

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

"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 2012 and 2011 operations in this document, refers to those centers that we have either ceased operating (including those under a sale agreement) or those centers that are new to our portfolio, since January 1, 2011;

"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 2012 and 2011 operations in this document, refers to those centers that were operated by us on January 1, 2011, and throughout 2011 and 2012; 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 46% 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 2012 approximately 82% of our admissions were Medicare or Managed Care funded, with 51% funded by Medicare and 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, we increase revenue. 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 their care, 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

Following the implementation of the 2011 CMS Final Rule, our average Medicare Part A and Managed Care rates declined in the 2011 fourth quarter by 11.0% and 7.0%, respectively, from the 2011 third quarter levels. The decline in our average rates in the 2011 fourth quarter was not as much as anticipated due to the transitional rules provided for in the changeover to the new assessment process. As a result, we experienced a further decline in our average Medicare Part A rates in the 2012 first quarter. In the 2012 first quarter, our average daily Medicare Part A and Managed Care rates were US$456.29 and US$426.07, respectively, and compared to the 2011 third quarter levels immediately prior to the implementation of the 2011 CMS Final Rule, they were lower by 12.5% and 6.9%, respectively. We estimate that the impact of the 2011 CMS Final Rule on our revenue and EBITDA is a reduction of approximately US$64 million on an annualized basis, prior to our cost saving measures.

For 2012, our average daily Medicare Part A and Managed Care rates, excluding prior period settlement adjustments declined by 8.4% and 2.4%, respectively, due to the impact of the 2011 CMS Final Rule, partially offset by the October 1, 2012 net market basket increase. For the 2012 fourth quarter, our average daily Medicare Part A and Managed Care rates, excluding prior period settlement adjustments, were US$470.21 and US$439.41, respectively. Compared to the 2011 fourth quarter levels, these average rates increased by 1.4% and 3.2%, respectively, and increased over the 2012 third quarter levels by 0.9% and 1.2%, respectively. The 2012 fourth quarter improvement in Medicare Part A rates was due to the 1.8% net market basket increase effective October 1, 2012 and improvements in acuity mix, partially offset by a reduction in co-insurance reimbursement. For a discussion of recent Medicare funding changes, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

Our average daily Medicaid rate, excluding prior period settlement adjustments, increased this quarter by 5.0% to US$194.03 over US$184.83 in the 2011 fourth quarter, and by 1.9% from US$190.42 in the 2012 third quarter. For 2012, the average daily Medicaid rate increased by 3.5% over 2011. However, revenue from the Medicaid rate increases was partially offset by higher state provider taxes, resulting in a net increase in 2012 of 2.7% over 2011, and a net increase of 4.3% this quarter in comparison to the 2011 fourth quarter. 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 of approximately US$1.3 million, the net increase in Medicaid rates in the 2012 fourth quarter was 3.3%. For the majority of the states in which we operate, Medicaid funding changes take effect in July and October. For a discussion of recent Medicaid funding changes, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

The following table provides the percentage of EHSI's revenue by payor source and the average revenue rates for its skilled nursing centers from total operations, excluding prior period settlement adjustments, for the past eight quarters and the 2012 and 2011 years.

	Q1		Q2		Q3		Q4		Year	
(total operations)	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Revenue by Payor Source *(%)*										
Medicare	**31.9**	36.7	**31.7**	36.2	**30.5**	34.8	**29.7**	32.2	**31.0**	34.9
Managed Care	**10.2**	10.3	**9.6**	10.1	**10.2**	10.0	**10.3**	9.6	**10.1**	10.0
Skilled Mix	**42.1**	47.0	**41.3**	46.3	**40.7**	44.8	**40.0**	41.8	**41.1**	44.9
Private/other	**8.8**	8.1	**9.0**	8.0	**9.4**	8.6	**9.7**	9.1	**9.2**	8.5
Quality Mix	**50.9**	55.1	**50.3**	54.3	**50.1**	53.4	**49.7**	50.9	**50.3**	53.4
Medicaid	**49.1**	44.9	**49.7**	45.7	**49.9**	46.6	**50.3**	49.1	**49.7**	46.6
	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	**456.29**	515.49	**455.25**	515.90	**466.23**	521.24	**470.21**	463.89	**461.45**	503.75
Medicare Parts A and B	**504.91**	552.58	**502.54**	555.03	**519.37**	569.12	**510.68**	513.24	**508.92**	546.91
Managed Care	**426.07**	447.77	**430.66**	441.06	**434.35**	457.71	**439.41**	425.80	**432.38**	442.81
Private/other	**232.15**	221.07	**236.02**	228.04	**237.80**	226.49	**235.69**	224.17	**235.39**	224.91
Medicaid	**185.00**	180.20	**186.83**	180.99	**190.42**	183.42	**194.03**	184.83	**188.87**	182.49
Weighted average	**256.19**	266.40	**256.75**	266.27	**260.47**	266.56	**261.78**	255.46	**258.66**	263.56

The following table provides the percentage of EHSI's revenue by payor source for its skilled nursing centers on a same-facility basis, excluding prior period settlement adjustments, for the past eight quarters and the 2012 and 2011 years.

	Q1		Q2		Q3		Q4		Year	
(same-facility operations)	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Revenue by Payor Source *(%)*										
Medicare	**32.1**	36.9	**32.0**	36.4	**30.6**	34.9	**29.7**	32.5	**31.1**	35.2
Managed Care	**10.9**	11.0	**10.3**	10.9	**10.3**	10.7	**10.3**	10.3	**10.4**	10.7
Skilled Mix	**43.0**	47.9	**42.3**	47.3	**40.9**	45.6	**40.0**	42.8	**41.5**	45.9
Private/other	**8.9**	8.3	**9.1**	8.1	**9.3**	8.7	**9.6**	9.1	**9.3**	8.5
Quality Mix	**51.9**	56.2	**51.4**	55.4	**50.2**	54.3	**49.6**	51.9	**50.8**	54.4
Medicaid	**48.1**	43.8	**48.6**	44.6	**49.8**	45.7	**50.4**	48.1	**49.2**	45.6
	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 41.5% in 2012 from 45.9% in 2011, primarily as a result of the impact of the 2011 CMS Final Rule and due to a decline in Skilled Mix census levels, as discussed in the following section. The decline in the 2012 fourth quarter to 40.0% from 40.9% in the 2012 third quarter was primarily due to a decline in Skilled Mix census levels.

On a same-facility basis, the percentage of Medicare residents receiving therapy services improved to 86.5% in the 2012 fourth quarter from 86.1% in the 2011 fourth quarter and 86.2% in the 2012 third quarter. For 2012 and 2011, this percentage was 85.8% and 86.3%, respectively.

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, for the past eight quarters and the 2012 and 2011 years.

	Q1		Q2		Q3		Q4		Year	
(total operations)	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Average Daily Census										
Medicare	**2,283**	2,524	**2,263**	2,451	**1,918**	2,296	**1,864**	2,250	**2,081**	2,379
Managed Care	**861**	871	**804**	862	**768**	818	**748**	814	**795**	841
Skilled Mix	**3,144**	3,395	**3,067**	3,313	**2,686**	3,114	**2,612**	3,064	**2,876**	3,220
Private/other	**1,365**	1,396	**1,366**	1,317	**1,287**	1,434	**1,321**	1,455	**1,334**	1,401
Quality Mix	**4,509**	4,791	**4,433**	4,630	**3,973**	4,548	**3,933**	4,519	**4,210**	4,621
Medicaid	**9,568**	9,476	**9,551**	9,477	**8,578**	9,545	**8,302**	9,532	**8,997**	9,508
Total	**14,077**	14,267	**13,984**	14,107	**12,551**	14,093	**12,235**	14,051	**13,207**	14,129
Census by Payor Type *(%)*										
Medicare	**16.2**	17.7	**16.2**	17.4	**15.3**	16.3	**15.2**	16.0	**15.8**	16.8
Managed Care	**6.1**	6.1	**5.7**	6.1	**6.1**	5.8	**6.1**	5.8	**6.0**	6.0
Skilled Mix	**22.3**	23.8	**21.9**	23.5	**21.4**	22.1	**21.3**	21.8	**21.8**	22.8
Private/other	**9.7**	9.8	**9.8**	9.3	**10.3**	10.2	**10.8**	10.4	**10.1**	9.9
Quality Mix	**32.0**	33.6	**31.7**	32.8	**31.7**	32.3	**32.1**	32.2	**31.9**	32.7
Medicaid	**68.0**	66.4	**68.3**	67.2	**68.3**	67.7	**67.9**	67.8	**68.1**	67.3
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Average occupancy *(%)*	**85.9**	86.3	**85.6**	85.3	**84.9**	85.6	**84.2**	85.4	**85.2**	85.7

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.

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 are the establishment of Active Life Transition Units (ALTUs) that are upgraded suites targeted to attract our short-term rehabilitation residents. We currently have 14 ALTUs and plan to continue to expand the number of centers with ALTUs within certain of our centers.

EHSI's total skilled nursing center ADC declined by 12.9%, or 1,816 ADC, to 12,235 in the 2012 fourth quarter from 14,051 in the 2011 fourth quarter. Of this decline, 1,615 in lower ADC related to non same-facility operations consisting of the 21 skilled nursing centers leased to a third party in 2012, one skilled nursing center that was sold in May 2011, and the balance of the 201 decline in ADC related to a decline in same-facility census. Our average occupancy in the 2012 fourth quarter was 84.2% compared to 85.4% in the 2011 fourth quarter and 84.9% in the 2012 third quarter.

For 2012, EHSI's total skilled nursing center ADC declined by 6.5%, or 922 ADC, to 13,207 from 14,129 in 2011. Of this decline, 801 in lower ADC related to non same-facility operations consisting of the 21 skilled nursing centers leased to a third party in 2012, one skilled nursing center that was sold in May 2011, and the balance of the 121 decline in ADC related to a decline in same-facility census. Our average occupancy in 2012 was 85.2% compared to 85.7% in 2011.

Our same-facility ADC of 12,235 in the 2012 fourth quarter was 201 below the 2011 fourth quarter level of 12,436 due to lower Skilled Mix ADC of 191 and Medicaid ADC of 12, partially offset by an increase in private/other ADC of two. In comparison to the 2012 third quarter, our same-facility ADC was lower by 118 due to lower Medicaid ADC of 111 and Skilled Mix ADC of 46, partially offset by an increase in private/other ADC of 39. Our average same-facility occupancy was 84.3% this quarter compared to 84.7% in the 2011 fourth quarter, and 84.8% in the 2012 third quarter.

For 2012, our same-facility ADC of 12,350 was 121 below the 2011 level of 12,471 due to lower Skilled Mix ADC of 200, partially offset an increase in Medicaid ADC of 76 and private/other ADC of three. Our average same-facility occupancy was 84.8% this year compared to 84.9% in 2011.

Our same-facility Skilled Mix ADC represented 21.4% of our residents in the 2012 fourth quarter compared to 22.5% in the 2011 fourth quarter and 21.5% in the 2012 third quarter. For 2012, our Skilled Mix ADC averaged 22.1% compared to 23.5% in 2011.

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers on a same-facility basis, for the past eight quarters and the 2012 and 2011 years.

	Q1		Q2		Q3		Q4		Year	
(same-facility operations)	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Average Daily Census										
Medicare	**2,037**	2,245	**2,026**	2,182	**1,896**	2,047	**1,864**	2,024	**1,955**	2,124
Managed Care	**825**	833	**769**	831	**762**	787	**748**	779	**776**	807
Skilled Mix	**2,862**	3,078	**2,795**	3,013	**2,658**	2,834	**2,612**	2,803	**2,731**	2,931
Private/other	**1,224**	1,261	**1,236**	1,178	**1,263**	1,277	**1,302**	1,300	**1,257**	1,254
Quality Mix	**4,086**	4,339	**4,031**	4,191	**3,921**	4,111	**3,914**	4,103	**3,988**	4,185
Medicaid	**8,370**	8,203	**8,326**	8,249	**8,432**	8,356	**8,321**	8,333	**8,362**	8,286
Total	**12,456**	12,542	**12,357**	12,440	**12,353**	12,467	**12,235**	12,436	**12,350**	12,471
Census by Payor Type *(%)*										
Medicare	**16.4**	17.9	**16.4**	17.5	**15.3**	16.4	**15.3**	16.3	**15.8**	17.0
Managed Care	**6.6**	6.6	**6.2**	6.7	**6.2**	6.3	**6.1**	6.2	**6.3**	6.5
Skilled Mix	**23.0**	24.5	**22.6**	24.2	**21.5**	22.7	**21.4**	22.5	**22.1**	23.5
Private/other	**9.8**	10.1	**10.0**	9.5	**10.2**	10.3	**10.6**	10.5	**10.2**	10.1
Quality Mix	**32.8**	34.6	**32.6**	33.7	**31.7**	33.0	**32.0**	33.0	**32.3**	33.6
Medicaid	**67.2**	65.4	**67.4**	66.3	**68.3**	67.0	**68.0**	67.0	**67.7**	66.4
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0	**100.0**	100.0
Average occupancy *(%)*	**85.2**	85.5	**84.8**	84.6	**84.8**	84.9	**84.3**	84.7	**84.8**	84.9

Canadian Operations

The funding received by ECI for its nursing homes 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 are ECI's average daily revenue rates and occupancy levels for the past eight quarters and the 2012 and 2011 years.

	Q1		Q2		Q3		Q4		Year	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Average revenue rate *($)*										
Total operations	**183.92**	181.16	**187.57**	182.94	**186.26**	181.66	**191.15**	191.00	**187.24**	184.25
Same-facility operations	**183.18**	179.06	**186.89**	181.90	**185.12**	181.39	**190.71**	189.31	**186.53**	182.90
Average occupancy *(%)*										
Total operations	**97.4**	96.4	**97.8**	96.7	**97.9**	97.5	**98.7**	97.2	**98.0**	96.9
Same-facility operations	**97.5**	97.8	**97.8**	97.8	**97.9**	98.0	**98.7**	97.6	**98.0**	97.8

Revenue from provincial programs represents approximately 66% of ECI's nursing home revenue during the year. For 2012, ECI's average daily rate for total operations increased by 1.6% to $187.24 from $184.25 in 2011, and for same-facility operations increased by 2.0% to $186.53 in 2012. The majority of ECI's nursing home 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, and is therefore matched with the related costs for resident care in the periods in which they 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 further information on funding in Canada, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada".

In Canada, where the supply of long-term care beds historically has been very restricted in comparison to the United States, nursing home operators typically enjoy higher occupancy levels than operators in the United States. Our same-facility average occupancy in Canada, excluding one new leased center in Ontario and the three new centers and two closed centers in Alberta, was 98.7% in the 2012 fourth quarter compared to 97.6% in the 2011 fourth quarter. 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.

Revenue from provincial programs represented approximately 97% of ECI's home health care revenue in 2012 and 2011. Our average daily home health care hours of service increased by 2.4% this quarter to 13,336 from 13,028 in the 2011 fourth quarter, and increased by 2.1% from 13,065 in the 2012 third quarter. For 2012, ParaMed provided 4,796,000 hours of home health care service, or 13,103 hours per day (2011 – 12,695 hours per day), of which 94.8% was from business in Ontario and the remainder from our Alberta operations. Since 2004, we had been unable to compete for new government contracts in Ontario due to the government's freeze on the competitive bidding process. As previously announced, the Ontario government implemented a new model for home health care beginning October 1, 2012, that does not involve a bidding process. All Community Care Access Centre (CCAC) home care contracts within the province concluded on September 30, 2012, and new open-ended, flexible CCAC home care contracts commenced on October 1, 2012. ParaMed signed new open-ended contracts for all of its existing CCAC contracts. The government has indicated their intention to provide six months' notice of loss 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. Select providers, including ParaMed, are participating in a proof-of-concept period to test the model and funding changes prior to March 31, 2013, which involves a small number of the CCACs as early adopters. 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".

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 64.2% of consolidated revenue from continuing operations in 2012 (2011 year – 66.7%). 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 table below illustrates the positive/(negative) effect of changes in the average exchange rates used in translating the U.S. results for the 2012 fourth quarter and the 2012 year.

	Q4		Year	
Exchange Rate Impact on Periods	**2012**	2011	**2012**	2011
Average U.S./Canadian dollar exchange rate	**0.9916**	1.0217	**0.9996**	0.9891
Continuing Operations *(millions of dollars)*				
Revenue	**(10.4)**		**13.7**	
EBITDA	**(0.6)**		**1.2**	
Net earnings (loss)	**(0.2)**		**0.9**	
AFFO	**(0.2)**		**0.5**	
Same-facility Operations *(millions of dollars)*				
Revenue	**(9.4)**		**12.9**	
EBITDA	**(0.5)**		**1.0**	

The following table illustrates the contribution from our U.S. operations to selected line items of our financial results for the years ended 2012 and 2011, and the resulting impact of a one-cent change in the Canadian dollar against the U.S. dollar.

U.S. Operations	2012 Results	Impact of One-Cent Change in Exchange Rate(1)
(millions of dollars)	*US$*	C$
Revenue	*1,309.0*	13.1
EBITDA	*111.1*	1.1
AFFO	*51.4*	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. EHSI had a contract that matured in June 2011, which converted US$4.0 million into Canadian dollars on a monthly basis at the prevailing exchange rate at that time subject to a floor of 1.00 and a ceiling of 1.09 (whereby US$1.00 converts to C$1.09). 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.

Adjusted Funds from Operations

The following table provides a reconciliation of our EBITDA to Funds from Operations (FFO) and AFFO for each of the eight most recently completed quarters and for the years ended 2012 and 2011.[1]

(millions of dollars unless otherwise noted)	Q1		Q2		Q3		Q4		Year	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
EBITDA	**49.4**	58.0	**43.6**	63.3	**37.3**	38.7	**52.9**	40.1	**183.2**	200.1
Depreciation for FFEC	**(5.8)**	(5.9)	**(6.3)**	(5.6)	**(5.7)**	(5.8)	**(5.8)**	(6.1)	**(23.6)**	(23.4)
Accretion costs	**(0.5)**	(0.5)	**(0.6)**	(0.5)	**(0.5)**	(0.5)	**(0.7)**	(0.5)	**(2.3)**	(2.0)
Interest expense, net	**(16.2)**	(21.5)	**(14.8)**	(22.1)	**(15.4)**	(21.9)	**(15.3)**	(19.8)	**(61.7)**	(85.3)
	26.9	30.1	**21.9**	35.1	**15.7**	10.5	**31.1**	13.7	**95.6**	89.4
Current income tax expense[2]	**(2.9)**	(9.4)	**(3.0)**	(11.0)	**(3.5)**	(8.8)	**2.4**	(1.8)	**(7.0)**	(31.0)
FFO (continuing)	**24.0**	20.7	**18.9**	24.1	**12.2**	1.7	**33.5**	11.9	**88.6**	58.4
Amortization of financing costs and accretion costs	**1.4**	1.9	**0.9**	2.9	**1.3**	4.1	**1.7**	2.5	**5.3**	11.4
Principal portion of government capital funding payments	**0.7**	0.6	**0.7**	0.7	**0.7**	0.7	**0.7**	0.6	**2.8**	2.6
Additional facility maintenance capital expenditures[3]	**1.0**	1.2	**(1.0)**	(1.5)	**(3.0)**	(3.3)	**(9.1)**	(4.0)	**(12.1)**	(7.6)
AFFO (continuing)	**27.1**	24.4	**19.5**	26.2	**11.2**	3.2	**26.8**	11.0	**84.6**	64.8
AFFO (discontinued)[4]	–	1.2	–	1.1	–	1.3	–	1.4	–	5.0
AFFO[5]	**27.1**	25.6	**19.5**	27.3	**11.2**	4.5	**26.8**	12.4	**84.6**	69.8
Per Basic Share/Unit[6] *($)*										
FFO (continuing)	**0.285**	0.249	**0.222**	0.290	**0.143**	0.020	**0.393**	0.142	**1.043**	0.701
AFFO (continuing)	**0.322**	0.294	**0.230**	0.315	**0.130**	0.037	**0.312**	0.131	**0.994**	0.777
AFFO	**0.322**	0.308	**0.230**	0.328	**0.130**	0.054	**0.312**	0.147	**0.994**	0.837
Per Diluted Share/Unit[6] *($)*										
FFO (continuing	**0.267**	0.236	**0.214**	0.271	**0.145**	0.039	**0.362**	0.143	**0.988**	0.689
AFFO (continuing)	**0.298**	0.274	**0.221**	0.292	**0.134**	0.055	**0.292**	0.134	**0.945**	0.755
AFFO	**0.298**	0.286	**0.221**	0.304	**0.134**	0.068	**0.292**	0.148	**0.945**	0.806
Distributions[6] *($)*										
Declared *(thousands)*	**17,729**	17,453	**17,825**	17,484	**17,922**	17,534	**18,021**	17,630	**71,497**	70,101
Declared per share/unit	**0.210**	0.210	**0.210**	0.210	**0.210**	0.210	**0.210**	0.210	**0.840**	0.840
Weighted Average Number of Shares/Units[6] *(thousands)*										
Basic	**84,347**	83,082	**84,805**	83,230	**85,260**	83,442	**85,736**	83,869	**85,039**	83,408
Diluted	**98,358**	96,895	**98,618**	96,980	**99,604**	97,255	**105,254**	97,682	**100,420**	97,205

(1) "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) The impact of discontinued operations affects FFO and AFFO by the same amount.

(5) A reconciliation of AFFO to cash flow from operating activities is provided under the heading "Liquidity and Capital Resources".

(6) For 2011, the per unit amounts, distributions declared and the weighted average number of units reported include the Class B units of Extendicare Limited Partnership (the "Exchangeable LP Units") that were fully exchanged for REIT Units in November 2011.

AFFO Review

2012 FOURTH QUARTER

AFFO from continuing operations was $26.8 million ($0.312 per basic share) in the 2012 fourth quarter. Excluding the $11.4 million increase in prior years' reserves recorded in the 2011 fourth quarter, AFFO from continuing operations that quarter was $22.4 million ($0.268 per basic share). This resulted in an improvement of $4.4 million between quarters. Excluding a $0.4 million negative effect of a stronger Canadian dollar, AFFO from continuing operations improved by $4.8 million, primarily due to an increase in EBITDA of $2.2 million, together with lower current income taxes and net interest costs, partially offset by higher facility maintenance capital expenditures. Excluding the impact of foreign exchange, net interest costs were lower by $3.3 million as a result of our debt refinancing. Current income taxes for the 2012 fourth quarter were a recovery of $2.4 million, and were favourably impacted by book-to-file adjustments of approximately $4.0 million. Excluding the 2012 fourth quarter book-to-file adjustments, current income taxes represented 5.2% of pre-tax funds from operations (FFO) this quarter compared to 13.4% in the 2011 fourth quarter. The 2012 effective current tax rate on FFO was favourably impacted by the proportion of earnings between taxable and non-taxable entities, particularly the impact of the lower level of reserves recorded in our non-taxable captive this year, and the utilization this year of non-capital loss carryforwards in Canada. A discussion of EBITDA by segmented division can be found under the heading "2012 Fourth Quarter Financial Review".

2012 AFFO

AFFO from continuing operations was $84.6 million ($0.994 per basic share) for the year ended December 31, 2012, compared to $64.8 million ($0.777 per basic share) in 2011. Excluding the increase in prior years' reserves of $16.6 million and $42.8 million, respectively, AFFO from continuing operations was $101.2 million ($1.190 per basic share) this year compared to $107.6 million ($1.290 per basic share) in 2011. Excluding a $0.7 million positive effect of a weaker Canadian dollar, AFFO from continuing operations declined by $7.1 million between years. This decrease was primarily due to a decline in EBITDA of $44.5 million and higher facility maintenance capital expenditures, partially offset by lower net interest costs and current income taxes. Excluding the impact of foreign exchange, net interest costs were lower by $17.5 million as a result of our debt refinancing. Current income taxes represented 7.3% of pre-tax FFO in 2012, which was below the previously estimated range of 14% to 18% because of favourable book-to-file adjustments recorded in the 2012 fourth quarter and changes in estimates of timing differences. In comparison to the FFO effective tax rate reported in 2011 of 34.7%, our effective tax rate this year was favourably impacted by the proportion of earnings between taxable and non-taxable entities, particularly the impact of the lower level of reserves recorded in our non-taxable captive this year, the utilization of non-capital loss carryforwards in Canada and favourable changes in timing differences between years. A discussion of EBITDA by segmented division can be found under the heading "2012 Financial Review".

The effective tax rates on our FFO can be impacted by: adjustments to our estimates of annual 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 elimination of the income trust structure under the 2012 Conversion, has enhanced our ability to realize available non-capital loss carryforwards, which reduced our current Canadian income taxes to a nominal level for the last half of 2012. As a result of the continued utilization of these non-capital loss carryforwards, we anticipate that our annual effective tax rate on FFO for the 2013 will be in the range of 18% to 22%.

Facility maintenance capital expenditures were $14.9 million in the 2012 fourth quarter, compared to $10.1 million in the 2011 fourth quarter and $8.7 million in the 2012 third quarter, representing 3.0%, 1.9% and 1.7% of revenue, respectively. For the year ended December 31, 2012, facility maintenance capital expenditures totalled $35.7 million, or 1.8% of revenue, compared to $31.0 million, or 1.5% of revenue, in 2011. 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 2013, we are expecting to spend in the range of $38 million to $44 million in facility maintenance capital expenditures and $35 million to $40 million in growth capital expenditures.

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.

Distributions declared in 2012 totalled $71.5 million, or $0.84 per share, representing approximately 85% of total AFFO of $84.6 million compared to approximately 100% in 2011. Excluding the impact of the increase in prior years' reserves for self-insured liabilities, distributions represented approximately 71% and 62% of total AFFO in the 2012 and 2011 years, respectively.

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.

Summary of Quarterly Results

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

(thousands of dollars unless otherwise noted)	Q1		Q2		Q3		Q4	
	2012	2011	**2012**	2011	**2012**	2011	**2012**	2011
Revenue	**517,188**	516,553	**524,686**	517,246	**498,505**	528,457	**497,034**	531,826
EBITDA(1)	**49,373**	57,964	**43,637**	63,295	**37,305**	38,774	**52,938**	40,103
EBITDA margin	***9.5%***	*11.2%*	***8.3%***	*12.2%*	***7.5%***	*7.3%*	***10.7%***	*7.5%*
Earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes(1)	**9,912**	9,118	**6,384**	14,199	**(3,264)**	(13,981)	**16,500**	(2,350)
Average U.S./Canadian dollar exchange rate(2)	**1.0011**	0.9856	**1.0103**	0.9681	**0.9956**	0.9807	**0.9916**	1.0217

(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 and distributions on Exchangeable LP Units, net of taxes"; and (ii) "earnings (loss) before income taxes" to "EBITDA" for each of the eight most recently completed quarters.

	Q1		Q2		Q3		Q4	
(thousands of dollars)	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Net earnings (loss)	**49,006**	(8,394)	**3,675**	30,278	**(4,651)**	(34,383)	**14,626**	(17,897)
Add (Deduct)[1]:								
Fair value adjustment on convertible debentures	**(4,987)**	8,033	**(120)**	(7,576)	**(2,029)**	(9,566)	**2,313**	9,686
Fair value adjustment on Exchangeable LP Units	–	10,555	–	(7,305)	–	(10,468)	–	618
Loss (gain) on foreign exchange and financial instruments	–	(988)	**1,103**	(90)	–	308	–	115
Loss (gain) from asset impairment, disposals and other items	**423**	417	**1,726**	(672)	**3,847**	40,779	**(367)**	6,284
Distributions on Exchangeable LP Units	–	662	–	652	–	649	–	216
Discontinued operations	**(34,530)**	(1,167)	–	(1,088)	**(431)**	(1,300)	**(72)**	(1,372)
Earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	**9,912**	9,118	**6,384**	14,199	**(3,264)**	(13,981)	**16,500**	(2,350)
Earnings (loss) before income taxes	**17,717**	(2,036)	**4,979**	37,213	**(491)**	(36,933)	**15,990**	(20,125)
Add (Deduct):								
Depreciation and amortization	**19,355**	19,200	**19,455**	18,694	**19,005**	19,096	**18,990**	19,587
Net finance costs	**11,661**	40,231	**16,393**	8,330	**13,944**	2,409	**18,325**	31,974
Loss (gain) from asset impairment, disposals and other items	**640**	569	**2,810**	(942)	**4,847**	54,202	**(367)**	8,667
EBITDA	**49,373**	57,964	**43,637**	63,295	**37,305**	38,774	**52,938**	40,103

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

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

	Q1		Q2		Q3		Q4	
(thousands of dollars)	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Segmented EBITDA								
U.S. operations *(US$)*	**33,721**	44,422	**26,239**	47,199	**17,191**	20,125	**33,923**	24,097
U.S. operations *(C$)*	**33,758**	43,782	**26,544**	45,713	**17,028**	19,803	**33,700**	25,064
Canadian operations	**15,615**	14,182	**17,093**	17,582	**20,277**	18,971	**19,238**	15,039
EBITDA	**49,373**	57,964	**43,637**	63,295	**37,305**	38,774	**52,938**	40,103

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 as 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 2012 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".

2012 Fourth Quarter Financial Review

CONSOLIDATED CONTINUING OPERATIONS

	Q4		Change	
(millions of dollars unless otherwise noted)	**2012**	2011	$	%
Revenue	**497.0**	531.8	(34.8)	*(6.5)%*
Operating expenses	**426.9**	471.5	(44.6)	*(9.5)%*
Administrative costs	**14.5**	17.3	(2.8)	*(16.2)%*
Lease costs	**2.7**	2.9	(0.2)	*(6.9)%*
EBITDA	**52.9**	40.1	12.8	*31.9%*
EBITDA as a % of revenue	***10.7%***	*7.5%*		
Average U.S./Canadian dollar exchange rate	**0.9916**	1.0217		

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 0.9916 for the 2012 fourth quarter and 1.0217 for the 2011 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 was $497.0 million in the 2012 fourth quarter, a decline of $24.4 million over the 2011 fourth quarter, primarily related to the exit from Kentucky, while same-facility operations grew by $4.9 million.
- Average daily revenue rates for Medicare Part A and Managed Care in the 2012 fourth quarter increased by 1.4% and 3.2%, respectively, over the 2011 fourth quarter.
- EBITDA was $52.9 million in the 2012 fourth quarter, and excluding reserve adjustments in the 2011 fourth quarter, was $2.2 million higher than the 2011 fourth quarter.
- EBITDA margin, excluding reserve adjustments, was 10.7% in the 2012 fourth quarter compared to 9.7% in the 2011 fourth quarter.

Consolidated revenue from continuing operations declined by $34.8 million to $497.0 million in the 2012 fourth quarter from $531.8 million in the 2011 fourth quarter. Non same-facility operations contributed $12.2 million to revenue this quarter and $42.5 million in the 2011 fourth quarter, for a net decline between quarters of $30.3 million. The non same-facility operations related to the impact of 27 centers and an assisted living wing, as follows: the 21 skilled nursing centers in Kentucky that were leased to a third party in 2012; a U.S. skilled nursing center that was sold in May 2011, and two Canadian nursing centers that closed in January and November 2011, partially offset by the addition of a new Canadian nursing center that was leased in May 2011, two new Canadian centers that opened in January and November 2011, and the designated assisted living wing of a new center that opened in February 2011. Excluding the $9.4 million negative effect of the stronger Canadian dollar, growth in revenue from same-facility operations of $4.9 million was primarily from the Canadian operations with the U.S. operations essentially flat. Details by segmented operations are discussed below.

Consolidated EBITDA from continuing operations was $52.9 million this quarter, or 10.7% of revenue. Excluding the $11.4 million (US$11.2 million) increase in prior years' reserve for self-insured liabilities recorded in the 2011 fourth quarter, EBITDA that quarter was $51.5 million, or 9.7% of revenue. This resulted in an increase in EBITDA of $1.4 million between quarters. Non same-facility operations generated EBITDA of $4.2 million in the 2012 fourth quarter compared to $8.1 million in the same 2011 period, for a net decline of $3.9 million between periods. Excluding a $0.9 million negative effect of a stronger Canadian dollar, same-facility EBITDA improved by $6.2 million, with an improvement from the Canadian operations of $4.6 million and $1.6 million from the U.S. operations. Details by segmented operations are discussed below.

Consolidated labour-related costs represented 74.3% of operating and administrative costs in the 2012 fourth quarter compared to 72.5% in the 2011 fourth quarter, and as a percentage of revenue, were 66.0% and 66.6%, respectively.

U.S. CONTINUING OPERATIONS

	Q4 2012		Q4 2011		Change	
(millions of dollars unless otherwise noted)	**US$**	**C$**	US$	C$	US$	%
Revenue	**313.6**	***310.8***	342.2	*350.3*	(28.6)	*(8.4)%*
Operating expenses	**268.0**	***265.5***	305.0	*311.7*	(37.0)	*(12.1)%*
Administrative costs	**10.1**	***10.1***	11.4	*11.8*	(1.3)	*(11.4)%*
Lease costs	**1.6**	***1.5***	1.7	*1.7*	(0.1)	*(5.9)%*
EBITDA	**33.9**	***33.7***	24.1	*25.1*	9.8	*40.7%*
EBITDA as a % of revenue	***10.8%***		*7.0%*			

Revenue from U.S. operations in its functional currency declined by US$28.6 million to US$313.6 million in the 2012 fourth quarter compared to US$342.2 million in the 2011 fourth quarter. Non same-facility operations generated revenue of US$3.7 million this quarter compared to US$33.3 million in the 2011 fourth quarter, for a net decline of US$29.6 million between quarters. Revenue from same-facility operations improved by US$1.0 million between periods primarily due to higher average rates, prior period revenue settlement adjustments and other revenue improvements, partially offset by lower census levels and a decline in nursing ancillary revenue. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

Same-facility Revenue: 2012 Fourth Quarter Compared to 2011 Fourth Quarter *(US$ millions)*

8.5	– increase in average skilled nursing center rates (Medicare $0.2 million, Managed Care $0.9 million, Medicaid $6.2 million and private/other $1.2 million)
(8.2)	– decrease in skilled nursing center resident census (Medicare $6.9 million, Managed Care $1.1 million, and Medicaid $0.2 million)
(2.0)	– decrease in nursing ancillary revenue (including $1.0 million for Part B denials in excess of annual limit)
1.4	– increase in prior period revenue settlement adjustments (receipt of $2.3 million in 2012 versus $0.9 million in 2011)
1.3	– increase in other revenue
1.0	

The operating, administrative and lease costs of our U.S. operations decreased by US$38.4 million to US$279.7 million this quarter compared to US$318.1 million in the 2011 fourth quarter. Excluding the US$11.2 million increase in prior years' reserves for self-insured liabilities recorded in the 2011 fourth quarter, costs declined by US$27.2 million between periods. Non same-facility operations incurred costs of US$0.7 million this quarter compared to US$27.0 million in the 2011 fourth quarter, for a net decline of US$26.3 million between periods. Costs associated with same-facility operations declined by US$0.9 million resulting from lower labour-related costs of US$5.2 million, primarily due to a change in vacation policy, partially offset by an increase in the provision for self-insured liabilities of US$2.5 million and a net increase in other costs of US$1.8 million. Labour-related costs from total operations represented 68.2% of operating and administrative costs this quarter, compared to 67.4% in the 2011 fourth quarter, and as a percentage of revenue were 60.5% and 62.3%, respectively.

EBITDA from U.S. operations was US$33.9 million this quarter, or 10.8% of revenue. Excluding the US$11.2 million increase in prior years' reserves for self-insured liabilities recorded in the 2011 fourth quarter, EBITDA that quarter was US$35.3 million, or 10.3% of revenue. This resulted in a decline in EBITDA of US$1.4 million between quarters. EBITDA from non same-facility operations was lower by US$3.3 million between periods. EBITDA from same-facility operations grew by US$1.9 million, resulting from the US$1.0 million increase in revenue and the decline in operating, administrative and lease costs of US$0.9 million, as previously discussed.

CANADIAN CONTINUING OPERATIONS

	Q4		Change	
(millions of dollars unless otherwise noted)	**2012**	2011	$	%
Revenue	**186.2**	181.5	4.7	*2.6%*
Operating expenses	**161.4**	159.8	1.6	*1.0%*
Administrative costs	**4.4**	5.5	(1.1)	*(20.0)%*
Lease costs	**1.2**	1.2	–	–
EBITDA	**19.2**	15.0	4.2	*28.0%*
EBITDA as a % of revenue	***10.3%***	*8.3%*		

Revenue from Canadian operations grew by $4.7 million to $186.2 million in the 2012 fourth quarter from $181.5 million in the 2011 fourth quarter. Of this improvement, $3.9 million was derived from nursing and assisted living center operations and included an increase of $0.3 million from non same-facility operations. Growth from same-facility nursing and assisted living center operations of $3.6 million was favourably impacted by a reversal of prior period revenue recorded in the 2011 fourth quarter of $2.0 million, with the remainder primarily due to funding enhancements. Revenue from home health care operations improved by $0.5 million this quarter, primarily due to a 2.4% increase in daily volumes, partially offset by lower average rates. Other revenue improved by $0.3 million.

Operating, administrative and lease costs increased by $0.5 million to $167.0 million this quarter from $166.5 million in the 2011 fourth quarter, of which $0.7 million was from non same-facility operations. Costs from same-facility operations declined by $0.2 million this quarter primarily due to lower administrative costs partially offset by higher costs of care. Labour-related costs from total operations represented 84.3% of operating and administrative costs in the 2012 fourth quarter compared to 82.3% in the 2011 fourth quarter, and as a percentage of revenue were 75.1% and 75.0%, respectively.

EBITDA from Canadian operations improved by $4.2 million to $19.2 million in the 2012 fourth quarter from $15.0 million in the 2011 fourth quarter and represented 10.3% and 8.3% of revenue, respectively. Non same-facility operations contributed $1.2 million this quarter and $1.6 million in the 2011 fourth quarter for a net decline of $0.4 million. EBITDA from same-facility operations improved by $4.6 million, of which $2.0 million was due to the 2011 fourth quarter prior period revenue reversal, with the balance due to higher revenue of $2.4 million and lower costs of $0.2 million, as previously discussed.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization costs of $19.0 million in the 2012 fourth quarter were lower by $0.6 million from $19.6 million in the 2011 fourth quarter, primarily due to a $0.5 million positive effect of a stronger Canadian dollar.

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

Extendicare recorded a pre-tax gain from asset impairment, disposals and other items of $0.4 million in the 2012 fourth quarter compared to a pre-tax loss of $8.7 million in the same 2011 period. The 2012 fourth quarter gain of $0.4 million related to the redemption of our 2013 Convertible Debentures. The 2011 third quarter pre-tax loss of $8.7 million included penalty fees of $8.3 million for the early retirement of debt and $0.4 million of advisor fees in respect of the 2012 Conversion. For further information, refer to *note 17* of the 2012 consolidated financial statements.

NET FINANCE COSTS

Net finance costs of $18.3 million in the 2012 fourth quarter were $13.6 million lower than the 2011 fourth quarter level of $31.9 million. This was largely due to a favourable change in the fair value adjustments of $9.1 million and lower net interest costs of $4.5 million resulting from the debt refinancing, partially offset by increased debt in connection with the Alberta projects completed in 2011. The Exchangeable LP Units were fully redeemed in November 2011 for REIT Units. Therefore, the 2012 results do not include a fair value adjustment or a distribution amount related to the Exchangeable LP Units.

The following table summarizes the components of net finance costs.

	Q4		Change	
(millions of dollars unless otherwise noted)	**2012**	2011	$	%
Interest, net				
Interest expense	**16.6**	20.4	(3.8)	*(18.6)%*
Interest revenue	**(1.3)**	(0.6)	(0.7)	*116.7%*
	15.3	19.8	(4.5)	*(22.7)%*
Accretion				
Accretion of decommissioning provisions	**0.4**	0.4	–	–
Other accretion	**0.3**	0.1	0.2	*200.0%*
	0.7	0.5	0.2	*40.0%*
Exchangeable LP Unit distributions	–	0.2	(0.2)	*(100.0)%*
Fair Value Adjustments and Loss on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	**2.3**	10.8	(8.5)	*(78.7)%*
Fair value adjustment on Exchangeable LP Units	–	0.6	(0.6)	*(100.0)%*
	2.3	11.4	(9.1)	*(79.8)%*
Net finance costs	**18.3**	31.9	(13.6)	*(42.6)%*

INCOME TAXES

The tax provision from continuing operations was $1.5 million on a pre-tax earnings of $16.0 million in the 2012 fourth quarter compared to a tax recovery of $0.9 million on a pre-tax loss of $20.1 million in the 2011 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. As well, the effective tax rates were impacted by a favourable book-to-file adjustment of $3.3 million recorded this quarter and the non-taxable adjustment to prior years' reserves for self-insured liabilities of $11.4 million recorded in the 2011 fourth quarter. Excluding these items, the effective tax rate was 26.6% this quarter compared to 22.2% in the 2011 fourth quarter. This change in rates was primarily due to the change in proportion of income among our taxable and non-taxable entities.

2012 Financial Review

Selected Annual Information

The following is a summary of selected annual financial information.

(thousands of dollars unless otherwise noted) Years ended December 31	**2012**	2011	2010
Revenue	**2,037,413**	2,094,082	2,097,416
Operating expenses	**1,780,019**	1,813,792	1,771,168
Administrative costs	**63,155**	69,155	72,630
Lease costs	**10,986**	10,999	11,548
	1,854,160	1,893,946	1,855,346
EBITDA	**183,253**	200,136	242,070
Depreciation and amortization	**76,805**	76,577	73,769
Loss from asset impairment, disposals, financing and other items	**7,930**	62,496	2,948
Results from operating activities	**98,518**	61,063	165,353
Interest, net	**61,741**	85,312	84,723
Accretion	**2,302**	2,029	2,128
Distributions on Exchangeable LP Units	**–**	2,179	2,702
Fair value adjustments	**(4,823)**	(6,023)	4,649
Loss (gain) on foreign exchange and financial instruments	**1,103**	(553)	(3,280)
Net finance costs	**60,323**	82,944	90,922
Earnings (loss) from continuing operations before income taxes	**38,195**	(21,881)	74,431
Income tax expense	**10,572**	13,442	37,527
Earnings (loss) from continuing operations	**27,623**	(35,323)	36,904
Discontinued operations	**35,033**	4,927	4,925
Net earnings (loss)	**62,656**	(30,396)	41,829
Add (Deduct):			
Fair value adjustment on convertible debentures, net of taxes	**(4,823)**	577	5,435
Fair value adjustment on Exchangeable LP Units, net of taxes	**–**	(6,600)	(1,579)
Loss (gain) on foreign exchange and financial instruments, net of taxes	**1,103**	(655)	(4,804)
Loss from asset impairment, disposals and other items, net of taxes	**5,629**	46,808	720
Distributions on Exchangeable LP Units, net of taxes	**–**	2,179	2,702
Discontinued operations, net of taxes	**(35,033)**	(4,927)	(4,925)
Earnings from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	**29,532**	6,986	39,378
Cash distributions per share/unit *($)*	**0.8400**	0.8400	0.8400
Total assets *(at year end)*	**1,807,916**	1,830,704	1,994,634
Long-term debt *(at year end)*	**1,038,787**	941,742	670,028
Long-term debt including current portion *(at year end)*	**1,132,235**	1,134,440	1,241,196
U.S./Canadian dollar exchange rate			
Average rate for the year	**0.9996**	0.9891	1.0299
Closing rate at year end	**0.9949**	1.0170	0.9946

A comparison between the 2012 and the 2011 results is provided in the following discussion "2012 Divisional Financial Review" and under the heading "Liquidity and Capital Resources".

At the end of 2010, a significant portion of the Company's long-term debt was due to mature in 2011 and was therefore classified as part of current liabilities. During 2011, the majority of this debt was refinanced. Refer to the discussion under the heading "Overview – Significant 2012 Events and Developments – 2011/2012 Refinancing Plan".

2012 Divisional Financial Review

The following is a summary by reporting segment of "revenue", "EBITDA", "net finance costs", "net earnings (loss)", and "earnings from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units".

				2012				2011
(millions of dollars unless otherwise noted)	**U.S.**	**U.S.**	**Canada**	**Total**	U.S.	U.S.	Canada	Total
	(US$)				*(US$)*			
Revenue	***1,309.0***	**1,308.5**	**728.9**	**2,037.4**	*1,411.1*	1,395.8	698.3	2,094.1
Operating expenses	***1,147.5***	**1,147.0**	**633.0**	**1,780.0**	*1,220.2*	1,206.9	606.9	1,813.8
Administrative costs	***43.9***	**44.0**	**19.2**	**63.2**	*48.4*	48.0	21.2	69.2
Lease costs	***6.5***	**6.5**	**4.5**	**11.0**	*6.7*	6.5	4.5	11.0
	1,197.9	**1,197.5**	**656.7**	**1,854.2**	*1,275.3*	1,261.4	632.6	1,894.0
EBITDA	***111.1***	**111.0**	**72.2**	**183.2**	*135.8*	134.4	65.7	200.1
Depreciation and amortization	***58.4***	**58.4**	**18.4**	**76.8**	*58.9*	58.3	18.3	76.6
Loss from asset impairment, disposals and other items	***4.6***	**4.7**	**3.2**	**7.9**	*56.0*	56.2	6.3	62.5
Results from operating activities	***48.1***	**47.9**	**50.6**	**98.5**	*20.9*	19.9	41.1	61.0
Interest, net	***32.2***	**32.2**	**29.5**	**61.7**	*52.8*	52.2	33.1	85.3
Accretion	***1.8***	**1.7**	**0.6**	**2.3**	*1.6*	1.6	0.4	2.0
Distributions on Exchangeable LP Units	–	–	–	–	–	–	2.2	2.2
Fair value adjustments	–	–	**(4.8)**	**(4.8)**	–	–	(6.0)	(6.0)
Loss (gain) on foreign exchange and financial instruments	–	–	**1.1**	**1.1**	*(0.2)*	(0.3)	(0.3)	(0.6)
Net finance costs	***34.0***	**33.9**	**26.4**	**60.3**	*54.2*	53.5	29.4	82.9
Earnings (loss) from continuing operations before income taxes	***14.1***	**14.0**	**24.2**	**38.2**	*(33.3)*	(33.6)	11.7	(21.9)
Income tax expense	***6.1***	**6.1**	**4.5**	**10.6**	*11.1*	10.8	2.6	13.4
Earnings (loss) from continuing operations	***8.0***	**7.9**	**19.7**	**27.6**	*(44.4)*	(44.4)	9.1	(35.3)
Discontinued operations	***34.5***	**35.0**	–	**35.0**	*5.0*	4.9	–	4.9
Net earnings (loss)	***42.5***	**42.9**	**19.7**	**62.6**	*(39.4)*	(39.5)	9.1	(30.4)
Add (Deduct)(1):								
Fair value adjustment on convertible debentures	–	–	**(4.8)**	**(4.8)**	–	–	0.6	0.6
Fair value adjustment on Exchangeable LP Units	–	–	–	–	–	–	(6.6)	(6.6)
Loss (gain) on foreign exchange and financial instruments	–	–	**1.1**	**1.1**	*(0.3)*	(0.4)	(0.3)	(0.7)
Loss (gain) from asset impairment, disposals and other items	***3.2***	**3.3**	**2.3**	**5.6**	*42.7*	42.9	3.9	46.8
Distributions on Exchangeable LP Units	–	–	–	–	–	–	2.2	2.2
Discontinued operations	***(34.5)***	**(35.0)**	–	**(35.0)**	*(5.0)*	(4.9)	–	(4.9)
Earnings from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	***11.2***	**11.2**	**18.3**	**29.5**	*(2.0)*	(1.9)	8.9	7.0
Average U.S./Canadian dollar exchange rate				**0.9996**				0.9891

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

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 0.9996 for 2012 and 0.9891 for 2011. 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)*

- Average daily revenue rates for Medicare Part A and Managed Care in 2012 declined by 8.4% and 2.4%, respectively, over 2011.
- EBITDA, excluding reserve adjustments, was $199.8 million in 2012, a decline of $44.5 million over 2011, of which $37.5 million was from same-facility operations.
- EBITDA margin, excluding reserve adjustments, was 9.8% in 2012 compared to 11.6% in 2011.

Consolidated revenue from continuing operations declined by $56.7 million to $2,037.4 million in 2012 from $2,094.1 million in 2011. Non same-facility operations contributed $112.8 million to revenue this year and $166.3 million in 2011, for a net decline between years of $53.5 million. Excluding the $12.9 million positive effect of the weaker Canadian dollar, revenue from same-facility operations declined between periods by $16.1 million, with an improvement from the Canadian operations of $20.7 million offset by the impact of the 2011 CMS Final Rule and lower census levels on the U.S. operations. Details by segmented operations are discussed below.

Consolidated EBITDA from continuing operations declined by $16.9 million to $183.2 million in 2012 from $200.1 million in 2011, and was 9.0% and 9.6% of revenue, respectively. Excluding the increase in prior years' reserves for self-insured liabilities of $16.6 million in 2012 and $42.8 million in 2011, EBITDA was $199.8 million, or 9.8% of revenue, this year compared to $242.9 million, or 11.6% of revenue, in 2011. This represented a decline of $43.1 million between years. Non same-facility operations generated EBITDA of $22.7 million in 2012 compared to $29.5 million in 2011, for a net decline of $6.8 million between years. Excluding a $1.2 million positive effect of a weaker Canadian dollar, same-facility EBITDA declined by $37.5 million, of which $43.2 million was from the U.S. operations, partially offset by a $5.7 million improvement from the Canadian operations. Details by segmented operations are discussed below.

Consolidated labour-related costs as a percentage of operating and administrative costs were 74.0% in 2012 compared to 72.8% in 2011, and as a percentage of revenue, were 66.9% and 65.4%, respectively.

U.S. CONTINUING OPERATIONS

Revenue from U.S. operations in its functional currency declined by US$102.1 million to US$1,309.0 million in 2012 compared to US$1,411.1 million in 2011. Non same-facility operations generated revenue of US$79.0 million this year compared to US$144.0 million in 2011, representing a decline of US$65.0 million between years. Revenue from same-facility operations declined by US$37.1 million between years primarily due to lower census levels and lower average Medicare and Managed Care rates, partially offset by higher average Medicaid and private/other rates and the extra day in 2012. The decline in our average Medicare and Managed Care rates reflects changes implemented by the 2011 CMS Final Rule. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

Same-facility Revenue: 2012 Compared to 2011 *(US$ millions)*

(30.8)	– decrease in skilled nursing center resident census (decrease in Medicare $31.3 million, Managed Care $4.7 million, partially offset by an increase in Medicaid $5.1 million and private/other $0.1 million)
(13.0)	– decrease in average skilled nursing center rates (decrease in Medicare $32.0 million and Managed Care $4.4 million, partially offset by an increase in Medicaid $18.7 million and private/other $4.7 million)
(1.5)	– decrease in prior period revenue settlement adjustments ($2.5 million in 2012 versus $4.0 million in 2011)
3.5	– increase in nursing ancillary revenue
3.1	– one extra day in the period
1.6	– increase in other revenue
(37.1)	

The operating, administrative and lease costs of our U.S. operations declined by US$77.4 million to US$1,197.9 million in 2012 compared to US$1,275.3 million in 2011. Excluding the increase in prior years' reserves for self-insured liabilities of US$16.6 million this year and US$43.3 million in 2011, costs were US$1,181.3 million this year compared to US$1,232.0 million in 2011. This represented a decline of US$50.7 million between years. Non same-store operations incurred costs of US$61.5 million this year compared to US$118.7 million in 2011, for a net decline of US$57.2 million between years. Same-facility costs increased by US$6.5 million and were affected primarily by higher state provider taxes of US$6.5 million and increased provisions for self-insured liabilities of US$6.2 million, partially offset by lower labour-related costs of US$1.8 million, primarily due to a change in vacation policy, and other net cost reductions of US$4.4 million. Labour-related costs from total operations represented 68.5% of operating and administrative costs in 2012 compared to 67.4% in 2011, and as a percentage of revenue were 62.3% and 60.6%, respectively.

EBITDA from U.S. operations was US$111.1 million in 2012 compared to US$135.8 million in 2011, and represented 8.5% and 9.6% of revenue, respectively. Excluding the increase in prior years' reserves for self-insured liabilities of US$16.6 million this year and US$43.3 million in 2011, EBITDA was US$127.7 million, or 9.8% of revenue, this year compared to US$179.1 million, or 12.7% of revenue, in 2011. This represented a decline of US$51.4 million between years. EBITDA from non same-facility operations was lower by US$7.8 million between years. Same-facility operations declined by US$43.6 million, resulting from the decline in revenue of US$37.1 million and higher operating, administrative and lease costs of US$6.5 million, as previously discussed.

CANADIAN CONTINUING OPERATIONS

Revenue from Canadian operations grew by $30.6 million, or 4.4%, to $728.9 million in 2012 from $698.3 million in 2011. Of this improvement, $24.4 million was derived from nursing and assisted living center operations and included an increase of $9.9 million from non same-facility operations. Growth from same-facility nursing and assisted living center operations of $14.5 million was primarily due to funding enhancements and included the favourable impact of a $2.0 million prior period revenue reversal recorded in 2011. Revenue from home health care operations improved by $5.3 million primarily due to a 3.2% increase in daily volumes. Other revenue increased by $0.9 million between periods.

Operating, administrative and lease costs increased by $24.1 million to $656.7 million in 2012 from $632.6 million in 2011, of which $9.1 million was from non same-facility operations. Costs from same-facility operations increased by $15.0 million primarily due to higher labour-related costs of approximately $15.8 million. Labour-related costs from total operations represented 84.0% of operating and administrative costs in 2012 and 83.5% in 2011, and as a percentage of revenue were 75.2% in 2012 compared to 75.1% in 2011.

EBITDA from Canadian operations improved by $6.5 million to $72.2 million in 2012 from $65.7 million in 2011, and represented 9.9% and 9.4% of revenue, respectively. Non same-facility operations contributed EBITDA of $5.2 million this year compared to $4.4 million in 2011, for a net improvement of $0.8 million between years. Same-facility operations improved by $5.7 million between years and included the favourable impact of $2.0 million in prior period revenue adjustments recorded in 2011. The remaining EBITDA improvement of $3.7 million was primarily due to funding enhancements, with higher revenue of $18.7 million partially offset by higher costs of $15.0 million, as previously discussed.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization costs of $76.8 million in 2012 were relatively unchanged from $76.6 million in 2011 and included a $0.6 million negative effect of a weaker Canadian dollar.

LOSS FROM ASSET IMPAIRMENT, DISPOSALS AND OTHER ITEMS

Extendicare recorded a pre-tax loss from asset impairment, disposals and other items of $7.9 million in 2012 compared to a pre-tax loss of $62.5 million in 2011. The pre-tax loss of $7.9 million reported in 2012 included a non-cash asset impairment charge of $2.8 million, a loss of $3.6 million in connection with the Kentucky lease transaction, and other costs of $1.5 million related to debt settlements and the 2012 Conversion. The pre-tax loss of $62.5 million reported in 2011 included a non-cash asset impairment charge of $54.0 million in connection with the revaluation of our U.S. property and goodwill resulting from the 2011 CMS Final Rule, $11.0 million in debt settlement costs and $0.4 million of advisor fees in respect of the 2012 Conversion, partially offset by a $0.5 million gain on the sale of property in Alberta and Michigan and a $2.4 million release of provisions for contingent liabilities. For further information, refer to *note 17* of the 2012 consolidated financial statements.

NET FINANCE COSTS

The following table summarizes the components of net finance costs.

(millions of dollars unless otherwise noted)	**2012**	2011	Change $	Change %
Interest, net				
Interest expense	**65.3**	89.6	(24.3)	*(27.1)%*
Interest revenue	**(3.6)**	(4.3)	0.7	*(16.3)%*
	61.7	85.3	(23.6)	*(27.7)%*
Accretion				
Accretion of decommissioning provisions	**1.7**	1.6	0.1	*6.3%*
Other accretion	**0.6**	0.4	0.2	*50.0%*
	2.3	2.0	0.3	*15.0%*
Exchangeable LP Unit distributions	–	2.2	(2.2)	*(100.0)%*
Fair Value Adjustments and Loss (Gain) on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	**(4.8)**	0.6	(5.4)	*(900.0)%*
Fair value adjustment on Exchangeable LP Units	–	(6.6)	6.6	*(100.0)%*
Loss (gain) on foreign exchange and financial instruments	**1.1**	(0.6)	1.7	*(283.3)%*
	(3.7)	(6.6)	2.9	*(43.9)%*
Net finance costs	**60.3**	82.9	(22.6)	*(27.3)%*

Net finance costs of $60.3 million in 2012 were $22.6 million below the 2011 level of $82.9 million. Net interest costs decreased by $23.6 million primarily due to our debt refinancing, partially offset by increased debt in connection with the Alberta projects completed in 2011 and a $0.3 million negative effect of the weaker Canadian dollar. The change in the fair value adjustments and loss (gain) on foreign exchange and financial instruments was unfavourable by $2.9 million between years. The Exchangeable LP Units were fully redeemed in November 2011 for REIT Units. Therefore, the 2012 results do not include a fair value adjustment or a distribution amount related to the Exchangeable LP Units.

INCOME TAXES

The tax provision from continuing operations was $10.6 million on pre-tax earnings of $38.2 million in 2012 compared to a tax provision of $13.4 million on a pre-tax loss of $21.9 million in 2011. 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 30.4% this period compared to 80.7% in 2011. As well, the effective tax rates of both periods were impacted by the non-taxable adjustment to prior years' reserves for self-insured liabilities of $16.6 million this year and $42.8 million in 2011, and the 2012 income taxes were favourably impacted by $4.4 million of book-to-file adjustments. Excluding these items, the effective tax rate was 29.2% this year compared to 37.0% in 2011. This decline 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 2012 Events and Developments", summarizes the impact of the following items: the 2012 corporate conversion; the 2012 Medicare update; the 2012 Kentucky lease transaction; provision for self-insured liabilities; the 2011/2012 refinancing plan; the EHSI Credit Facility and the 2011 CMS Final Rule. This section provides a summary of other developments that have impacted the financial results or operations of Extendicare for 2012 in comparison to 2011.

Development Projects

COMPLETED PROJECTS (2011)

The following table summarizes the construction projects completed during 2011. The Edmonton and Lethbridge centers were completed at a cost of approximately $41.0 million, net of government grants. The Lansing, Michigan project is owned by a third-party, and is operated by EHSI under a 10-year lease arrangement.

Completed Projects *(2011)*	Date Opened for Admissions	No. of Centers	Operational Beds/Units
Canada – Owned Centers			
Designated assisted living center, Lethbridge, Alberta	Jan./11[(1)]	1	140
Nursing center, Edmonton, Alberta	Nov./11[(2)]	1	180
U.S. – Leased Centers			
Skilled nursing center, Lansing, Michigan	Jan./11	1	120
		3	**440**

(1) The new Lethbridge center was completed in December 2010 and opened in January 2011. Our existing Lethbridge center closed upon the opening of the new center, and had been transitioned down to 62 beds at the end of 2010 (from 120 beds) in anticipation of its closure in January 2011.

(2) The new Edmonton center was completed in October 2011 and opened in November 2011. Residents from our existing Edmonton center (113 beds) that closed and 9 beds from another one of our centers were transferred to the new center.

PROJECTS UNDER DEVELOPMENT

The following table depicts the status of the development projects in progress in Ontario, Canada. Two of our existing owned nursing centers and one leased center that we operate in the region will close upon completion of the new centers. Further details of these projects are provided below.

		New Centers		Owned/Leased Centers to Close	
Development Projects *(as at December 31, 2012)*	Estimated Completion 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	1	256	(2)	(263)
Timmins, Ontario	June/13	1	180	(1)	(119)
		2	**436**	**(3)**	**(382)**

Ontario Redevelopment Projects – Awarded

As part of the Government of Ontario's initiative to redevelop 35,000 long-term care beds over the next 10 to 15 years (refer to discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada – Ontario Long-term Care Legislation"), ECI received approval to redevelop 382 beds in the cities of Timmins and Sault Ste. Marie and add an additional 54 long-term care beds to its portfolio. ECI began construction in the spring of 2011 and expects to complete a new 256-bed nursing center in Sault Ste. Marie in March 2013, and a new 180-bed nursing center in Timmins in June 2013. ECI currently owns and operates three nursing centers with 387 class "C" beds and leases one center with 95 interim beds in these areas. Following completion of the new projects, ECI will own and operate 436 beds in two new centers and 100 class "C" beds in an existing center to be considered for redevelopment at a later date.

The cost of the two Ontario projects is estimated to be $80 million, of which $55.8 million had been spent to December 31, 2012. Conventional financing for approximately 88% of the total estimated cost for the two projects was secured at the end of October 2011. In addition, we will receive capital funding from the government of approximately $2.0 million annually over a 25-year period. The combined annual 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 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

For details on the refinancing of a significant portion of Extendicare's U.S. and Canadian long-term debt, refer to the discussion under the headings "2011/2012 Refinancing Plan" and "EHSI Credit Facility" under the heading "Overview – Significant 2012 Events and Developments".

CANADA

Mortgage Activity – Development Projects

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

In October 2011, ECI secured conventional long-term financing on its Sault Ste. Marie and Timmins projects in Ontario for up to $41.3 million and $28.6 million, respectively. 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 Sault Ste. Marie and Timmins loans contain fixed rates for the full 27-year term of 5.637% and 5.558%, respectively, and a requirement to maintain a minimum debt service coverage ratio.

UNITED STATES

Sovereign Loans – June 2011

On June 1, 2011, EHSI paid off the remaining US$43.0 million balance of its Sovereign Loans using borrowings under the EHSI Credit Facility that were subsequently repaid upon closing of the first phase of the HUD loans at the end of June 2011.

In May 2011, EHSI repaid US$1.7 million of the Sovereign Loans relating to the sale of the Saginaw, Michigan, nursing center.

Divestitures and Assets 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. During 2011, Extendicare classified its U.S. group purchasing operations as discontinued operations as a result of its pending sale in January 2012, as discussed further below.

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 to be closed upon completion of new centers, compared to $1.4 million at December 31, 2011, related to a closed nursing center in Washington and the U.S. group purchasing operations.

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.

2011 ACTIVITY

In May 2011, EHSI completed the sale of the Saginaw, Michigan, skilled nursing center (92 beds) for net proceeds of $3.8 million (US$3.9 million) that resulted in a pre-tax gain of $0.3 million (US$0.3 million).

In June 2011, ECI completed the sale of its closed nursing center in Lethbridge, Alberta, for net proceeds of $1.0 million that resulted in a pre-tax gain of $0.2 million in the 2011 second quarter. During the 2011 first quarter, a charge of $0.6 million was recorded related to the prepayment penalty on the mortgage for this property when the center was closed.

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 74% of our consolidated operating costs for 2012 (2011 – 73%). 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, 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 has taken action to reduce operational and corporate office staff and realize savings in supplies, drugs, and third-party service arrangements with vendors. These savings have reduced general, administrative and non-wage operating costs of EHSI 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, the net negative effect of the 2011 CMS Final Rule on our EBITDA, partially offset by our cost saving initiatives, is 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 SHORT-TERM ADMISSIONS IN THE U.S.

In the U.S., Medicare and Managed Care funded residents were the source of approximately 82% of our admissions in 2012. Our average skilled nursing center occupancy rates have declined from 87.9% in 2009 to 86.0% in 2010, 85.7% in 2011, and to 85.2% in 2012. However, due to the implementation of programs to attract short-term rehabilitation residents, our Skilled Mix census as a percentage of our total center census has improved from 21.9% in 2009 to 22.1% in 2010 and 22.8% in 2011, but has declined to 21.8% in 2012, due to reasons discussed below.

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 the decline we have experienced in Medicare and total admissions was in part due to individuals deferring hospital elective surgery 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 rates has been the concerted effort by state Medicaid programs to shift potential residents to home care programs and assisted living centers along with Managed Care programs constraining the period of coverage in skilled nursing centers 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 are 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 14 ALTUs and plan to continue to expand the number of ALTUs within certain of our centers.

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 and, where appropriate, accrues for costs that may result from such investigations to the extent such costs are probable and estimable.

As previously disclosed, EHSI has received subpoenas from the U.S. Department of Health and Human Services (DHHS), Office of the Inspector General (OIG), relating to the possible submission of claims that they believe may be in violation of the U.S. Social Security Act. In November 2012 and March 2013, representatives of the OIG and the U.S. Department of Justice (DOJ) met with senior representatives of EHSI to discuss their investigation to date related to quality of care. EHSI continues to cooperate with them in their investigation, which also includes the provision and billing of rehabilitation services.

If Extendicare is found to have violated the U.S. Social Security Act or other applicable laws and regulations, Extendicare may incur, among other things, fines, civil monetary penalties, recoupments and administrative sanctions (including suspension or exclusion from participation in the Medicare and Medicaid programs). Any of these outcomes could have a material adverse effect on the business, results of operations, or financial condition of Extendicare. At the present time, Extendicare is unable to predict the ultimate outcome of the DHHS OIG subpoenas referred to above, including any required corrective action, or to estimate the costs that may result. Extendicare believes that it is in material compliance with the U.S. Social Security Act and other applicable laws and regulations. Based on current knowledge, management does not believe that liabilities, if any, arising from these matters will have a material adverse effect on the consolidated financial position, or results of operations of Extendicare.

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 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 64.2% of its revenue from continuing operations was earned in 2012 (2011 – 66.7%). 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 2012, approximately 51% of our U.S. resident admissions were Medicare funded and approximately 31% 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 discussed below, 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.

As announced by CMS on July 27, 2012, the net market basket increase for October 2012 was 1.8%, which consisted of a market basket increase of 2.5% minus a productivity adjustment of 0.7%. We estimate that the impact of this 1.8% rate increase will provide us with additional Medicare revenue of approximately US$6.0 million per annum.

The net market basket increase in each of October 2011 and 2010 was 1.7%. The October 2011 funding changes included a market basket update of 2.7% minus a productivity adjustment of approximately 1.0%. The October 2010 net 1.7% increase represented a 2.3% market basket increase, less a 0.6% forecasting error adjustment. These market basket increases were prior to the impact of the implementation of MDS 3.0 and RUG-IV in October 2010, and the 2011 CMS Final Rule implemented in October 2011, that included a parity adjustment, the elimination of group therapy and changes in the assessment process, as discussed 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). 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 revenue by approximately US$6.7 million.
- A decrease in reimbursement for Medicare Part B services due to an increase in the multiple procedure payment reduction percentage from 25% to 50% effective April 1, 2013. EHSI estimates that this reduction will reduce annual therapy revenue by approximately US$2.7 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 physical therapy and US$3,700 annually for speech therapy.

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 act 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 ATRA, as discussed above. A 2% Medicare funding reduction resulting from sequestration is estimated to reduce our revenue and EBITDA by approximately US$6.7 million per annum.

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 ATRA, as discussed above.
- Extended the therapy caps exception process through December 31, 2012. This process was later extended through December 31, 2013 by 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. The phased-in reduction of ultimately 35% over three years will result in an annual reduction of revenue to EHSI of approximately US$1.9 million in the first year, reaching approximately US$5.6 million in the third year. 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. 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 70% that will be reduced to 65% in 2013.

Medicare Reimbursement Changes Effective October 1, 2011

The implementation on October 1, 2010, of the RUG-IV rate set and MDS 3.0 by CMS was intended to be budget neutral. The post-implementation review completed by CMS determined that the majority of operators, including EHSI, realized increased Medicare reimbursement beyond the intended 1.7%. EHSI experienced a net increase in its average Medicare Part A rates of 12.7% for the first nine months of 2011 over the same 2010 period.

In response to this, the 2011 CMS Final Rule included a parity adjustment of 12.6% along with changes in the assessment process and the elimination of payment for group therapy. More specifically, the 2011 CMS Final Rule included, among other things, the following changes effective October 1, 2011:

- a parity adjustment of an estimated aggregate reduction of 11.1% (a 12.6% recalibration of the CMI, partially offset by a market basket increase net of a productivity adjustment);
- changes to group therapy, which has been defined to be four patients who are simultaneously performing similar activities, and minutes are allocated;

- implementation of Other Medicare-required Assessments, or "OMRAs", whenever a patient's RUG-IV classification changes;
- clarification that End of Therapy (EOT) OMRAs must be completed following three consecutive calendar days without therapy services;
- implementation of the EOT-Resumption of therapy (EOT-R) OMRAs, in place of a Start-of-Therapy OMRAs, in cases where the resumption of therapy is no more than five consecutive calendar days after the last day of therapy provided, and there has been no change in the RUG-IV classification; and
- implementation of a new assessment to be completed every seven calendar days to update current therapy provided, regardless of whether there has been a significant change in condition.

For an outline of the financial impact and mitigation efforts taken by EHSI, refer to the discussion under the heading "Overview – Significant 2012 Events and Developments – 2011 CMS Final Rule".

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 their full implementation through U.S. Congressional action that established exceptions for individuals who were able to prove medical necessity for the therapy. Effective January 1, 2013, ATRA extended the CMS caps on Part B therapy services for physical and speech therapy at US$1,900 and for occupational therapy at US$1,900, and also extended the automatic exception if the therapy services are considered medically necessary.

Effective October 1, 2012, CMS established a new manual medical review pre-approval process for annual therapy charges in excess of US$3,700 for physical and speech therapy and a similar pre-approval process for charges in excess of US$3,700 for occupational therapy. In the 2012 fourth quarter, EHSI recorded negative revenue adjustments of US$1.0 million related to the denial of therapy services in excess of US$3,700. The ATRA has extended this review process through December 31, 2013. Approval or denial of therapy services beyond these caps is determined on an individual basis and, therefore, the impact cannot be precisely determined. Based on the total Part B therapy provided by EHSI in 2012 in excess of US$3,700 and the percentage of denials received during the 2012 fourth quarter, the annual loss in revenue to EHSI will be approximately US$4.8 million, assuming there are no recoveries through the appeal process.

We continue to dialogue with policymakers about the impact of the therapy caps on access to care and quality of life for our residents. The impact of these therapy caps may be mitigated to a certain extent by reductions in staffing and, in some cases, residents paying for these services.

2012 President's Budget

In February 2011, the U.S. President released the 2012 fiscal year budget (the "2012 President's Budget"). The significant item within the 2012 President's Budget impacting the long-term care sector was the proposed reduction in the Medicaid Provider Tax Threshold. Commencing in 2015, the Medicaid Provider Tax Threshold would be reduced in phases over a three-year period. In the interim, the maximum percentage would be allowed to rise to 6.0% from 5.5% on October 1, 2011. Commencing in fiscal year (FY) 2015, the percentage would be phased down to: 4.5% in FY 2015; 4.0% in FY 2016; and 3.5% in FY 2017 and beyond. Provider taxes provide a significant source of FMAP funding and, therefore, this proposal could have had a negative effect on state budgets during the phase-down period. Although the 2012 President's Budget was not passed, reductions in the provider tax percentage remain a potential issue in the upcoming sequestration and debt ceiling resolution discussions.

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), which contains several changes to the PPACA. The legislation is complex and there is considerable controversy surrounding its passage. 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 President in November 2012 eliminated the possibility of the PPACA from being repealed. However, the implementation of the PPACA could be impacted by refinements to the legislation. It is generally believed that additional amendments may be introduced to address certain unintended consequences of the sweeping legislation before it is fully implemented in 2014. In addition, various government agencies will be required to issue regulations to properly implement the new legislation, which could have a significant impact on individuals, health care providers and employers.

The PPACA requires all individuals to have a minimum level of health care coverage and requires employers to provide health coverage, with certain stipulations, for employees. The legislation will increase 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". Commencing on January 1, 2014, all employers will have to either offer insurance for all full-time employees or pay an employer tax. For employers, that offer coverage, the health care plan must provide a minimum credible 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, 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 employees have joined one of EHSI's programs. There has been no material impact from the legislation on our health plan costs as a result of certain plan changes that we implemented to date. 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 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) DHHS 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 doctors' 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 Increases

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, 2012, Medicaid rates have been issued for Idaho, Indiana, Ohio, Oregon, Pennsylvania and Washington. The net Medicaid funding for these states, defined as Medicaid rates less provider taxes, increased by approximately 2.4%, or US$7.6 million on an annualized basis. The Wisconsin net Medicaid funding changes have not been issued, but are anticipated to increase by 2.3%, or US$1.4 million on an annualized basis, retroactive to July 1, 2012. The October 1, 2012, net Medicaid funding for Minnesota and West Virginia has increased by approximately 0.1%, or US$0.1 million on an annualized basis. The Michigan Medicaid funding changes have not been issued yet, but are anticipated to increase by approximately 9.0%, or US$5.7 million on an annualized basis. The January 1, 2012, net Medicaid funding for Delaware decreased by approximately 0.4%, or US$0.1 million on an annualized basis.

The 2012 net Medicaid funding, as of the respective dates for all 11 states in which EHSI operates, is anticipated to increase by 3.0%, or US$14.7 million on an annualized basis (2011 – net increase of 0.9%, or US$5.0 million, excluding Kentucky). This estimate could be impacted by CMI changes and Medicaid occupancy changes, along with other factors. During the 2012 fourth quarter, EHSI became eligible to receive Upper Payment Limit funding at all of its nursing centers in Indiana. Exclusive of this additional funding, the average 2012 increase in net Medicaid rates was approximately 1.8%.

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 for up to 25 years, depending on bed classifications (licenses can be revoked in cases of 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 three years' notice before the end of the term of a license as to whether a new license will be issued.

The fees charged by ECI for its Canadian nursing centers and home health care services are regulated by provincial authorities, and provincial programs fund a substantial portion of these fees, with the remainder 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 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 provincial government 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 provincial government (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 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 100% funding. During 2011, if the average occupancy fell below 97%, but remained above 85%, the center was funded based on actual occupancy +3%, and if it fell below 85%, the funding was based on actual occupancy. For 2012, the province extended the occupancy protection for levels between 90–97% on a graded scale with those between 90–94% receiving +1% and those between 94–97% receiving +2%. In March 2013, the Ontario government announced that it is extending the 2012 occupancy protection at the same rates for 2013. In total, ECI's Ontario nursing centers averaged 98% occupancy during 2012, with only one of its centers averaging slightly below 97%.

ONTARIO REDEVELOPMENT PROGRAM

In July 2007, the Ontario government initiated plans to redevelop 35,000 older long-term care beds in five phases over the next 10 to 15 years, and provide qualified applicants with a 25-year construction funding subsidy. In November 2008, the government released the range of the base construction funding subsidy, which for nursing centers larger than 100 beds is a daily subsidy of $13.30 per bed over a 25-year period, and an additional $1.00 per bed if the center is LEED Silver compliant. The majority of operators believe that the level of capital funding is insufficient given the current costs of construction and the new design standards. 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. ECI and other operators continue to express concerns about the adequacy of the construction funding subsidy. The Ontario government commenced a review of the program and has received a number of recommendations, but at this time has not communicated any changes to the program.

ECI owns 23 nursing centers with 3,572 class "C" beds and leases one center with 95 interim beds that require redevelopment to meet the new standards. The first round of submissions for approval under the redevelopment plan began in July 2009. There has been no announcement on the timing of the second round of submissions, which was expected to take place in mid-2011. Under the first phase of the redevelopment program, ECI received approval to redevelop 382 beds and is reviewing its remaining buildings to determine the priorities for redevelopment over future phases. Should ECI decide to replace or redevelop 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. Management estimates that approximately 20% to 25% of the total cost will be required to be funded by equity. ECI may choose not to replace certain of its centers and in other cases, form strategic partnerships with other providers for the replacement of their centers.

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 Ontario government 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. Initially, twenty-seven of ECI's centers were to have been fully transitioned to the new funding model by April 2012, with the remaining seven homes fully transitioned by April 2015. However, to facilitate funding stability in the long-term care sector and prevent unsustainable swings in funding, the government implemented a 5% CMI corridor in 2012 and will continue with this funding scheme for all centers during fiscal 2013/14. It is unknown at this time if this CMI corridor funding will be applied in fiscal 2014/15.

On April 1st each year, the Ontario government generally provides flow-through funding adjustments on the government funded portion of the fees. This year, funding increases of approximately 1% were received in the flow-through envelopes effective April 1, 2012, along with our CMI adjustments. These enhancements are estimated to provide additional revenue to ECI of approximately $1.5 million to offset additional costs for resident care and services within the nursing and program envelopes (April 2011 – $1.1 million).

On July 1st each year, the Ontario government generally implements annual accommodation funding increases to the per diem rates provided to long-term care providers. In May 2012, the Ontario government announced changes to the accommodation funding to long-term care providers that increased the daily rates for food costs by $0.22 and the non-flow-through component of the accommodation envelope by $1.09 effective July 1, 2012. ECI estimates that this enhanced funding will increase its annual revenue by approximately $2.4 million (July 2011 – $1.5 million). At the same time, the government confirmed the continuation of the "one-time" funding increase received in July 2011 ($0.13 for food and $0.69 for accommodation), by including it in the base upon which the new July 2012 rate was determined.

In addition to the July 2012 basic accommodation funding increases, the Ontario government has introduced a modest increase to the preferred accommodation premiums that long-term care providers can charge and retain for private and semi-private rooms. This is the first increase in preferred accommodation premiums since 1993. However, the increase is only applicable to newly admitted residents to beds that are classified as "New" or "A" beds, on or after July 1, 2012. For these residents, the premiums increase to $9.00 for semi-private and $19.75 for private. Existing residents and new admissions to "B" and "C" beds will continue to pay the lower preferred accommodation premiums of $8.00 for semi-private and $18.00 for private. ECI has 11 homes in Ontario classified as "New" with 1,411 beds, of which 845 offer private accommodation. We will benefit from this premium increase over time as new residents are admitted.

In October 2012, the Ontario government announced changes that will improve the funding and related managerial flexibilities to all long-term care providers. Currently, long-term care providers refund to the Ontario government underspent amounts, or conversely absorb the loss of any overspent amounts, for each of the flow-through envelopes. 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 government 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 have 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 increased union wages in the long-term care sector affecting ECI during this period. As a result, the incremental cost of these arbitrated wage increases to ECI, and other operators in the sector, has put pressure on ECI's operating margins.

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, Alberta Health Services (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, as part of the fiscal 2011-2012 funding, and is subject to further development as quality information and indicators become available. In each of the past two fiscal years, the QIF program has consisted of four pre-determined indicators that were 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, 2012, the Alberta government provided funding increases to long-term care providers that included a base funding increase of 3.5%, and additional changes based on the CMI levels of the residents. ECI estimates that its funding has improved by an average of 4.9% representing annual revenue of approximately $4.0 million (April 2011 – $2.7 million).

In October 2012, the Alberta government announced a 5% increase in the long-term care accommodation fees (the portion paid directly by the residents), effective January 1, 2013, 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 Canada through ParaMed, which operates in Alberta and Ontario. Ontario is ParaMed's largest market, representing approximately 96% of its revenue in 2012.

The Ontario home health care competitive bidding process for contracts had been frozen since 2004 while the government underwent a study to improve the procurement model, and during this period, existing contracts were extended. In June 2012, the Ontario government announced the implementation of a new model for home health care that will not involve a bidding process. All CCAC home care contracts within the province concluded on September 30, 2012, and new open-ended, flexible CCAC home care contracts commenced on October 1, 2012. ParaMed signed new open-ended contracts for all of its existing CCAC contracts. The government has indicated their intention to provide six months' notice of loss 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.

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 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 expected to begin in October 2013, 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 program, 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.

The *Employment Standards Amendment Act (Temporary Help Agencies), 2009* (the "ESAA"), came into effect in November 2009, and established, among other things, that temporary employees are covered by the *Employment Standards Act, 2000*, thereby providing them with entitlements to severance and notice of termination. At the time of its implementation in November 2009, the ESAA did not apply to elect-to-work employees of agencies, such as ParaMed, providing services pursuant to contracts with the CCACs. However, despite our industry's lobbying efforts, this exemption expired on September 30, 2012, and the ESAA now applies to all elect-to-work employees. The impact of the ESAA on ParaMed's contracts to parties other than the CCACs is minimal. In anticipation of the exemption expiration on September 30, 2012, that impacts our CCAC contracts, we made some internal process changes and, as result, the impact to us of these new standards has been minimal.

Liquidity and Capital Resources

Sources and Uses of Cash

At December 31, 2012, Extendicare had cash and short-term investments of $71.4 million compared with $80.0 million at December 31, 2011, representing a decline of $8.6 million. Cash declined from the beginning of the year largely due to cash used in connection with the refinancing of a significant portion of our U.S. debt, partially offset by the proceeds from the sale of the U.S. group purchasing operations. Cash pledged of $28.7 million (US$28.9 million) is excluded from our available cash balance as it relates to US$10.2 million held by the Royal Bank of Canada (RBC) as collateral against a letter of credit and US$18.7 million held in escrow pursuant to the HUD regulatory agreements for working capital purposes.

Sources and Uses of Cash *(thousands of dollars unless otherwise noted)*	**2012**	2011
Cash provided by operating activities, before working capital changes and interest and income taxes	**198,848**	238,547
Net change in operating assets and liabilities		
Accounts receivable	**21,111**	(10,545)
Other current assets	**759**	(11,210)
Accounts payable and accrued liabilities	**(31,701)**	(4,525)
	(9,831)	(26,280)
Interest and taxes paid		
Interest paid	**(60,276)**	(83,531)
Interest received	**3,509**	4,278
Income taxes paid	**(23,463)**	(26,235)
	(80,230)	(105,488)
Net cash from operating activities	**108,787**	106,779
Net cash used in investing activities	**(33,143)**	(67,906)
Net cash used in financing activities	**(83,150)**	(227,243)
Foreign exchange gain (loss) on U.S. cash held	**(1,114)**	629
Decrease in cash and short-term investments	**(8,620)**	(187,741)
Cash and short-term investments at beginning of year	**80,018**	267,759
Cash and short-term investments at end of year	**71,398**	80,018
Average U.S./Canadian dollar exchange rate	**0.9996**	0.9891

Net cash from operating activities was a source of $108.8 million in 2012 compared to $106.8 million in 2011, representing an increase of $2.0 million. The decline in earnings after cash interest and taxes paid was offset by a favourable net change in operating assets and liabilities between years. The change in the operating assets and liabilities were favourably impacted by the transfer of the Kentucky operations to a third party and the timing of receipt of Medicare Part A and Part B receivables that had been delayed at the end of 2011.

Net cash used in investing activities was $33.1 million in 2012 compared to $67.9 million in 2011. 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. The 2011 activity reflected expenditures for property, equipment and software and the acquisition of a previously leased skilled nursing center for $7.3 million, partially offset by the sale of two properties for net cash proceeds of $4.8 million.

Purchases of property, equipment and software were $84.1 million in 2012 compared to $64.3 million in 2011. Growth capital expenditures, excluding acquisitions, were $49.2 million compared to $33.5 million in 2011, 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 $35.7 million in 2012 compared to $31.0 million in 2011, representing 1.8% and 1.5% 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 $44 million in facility maintenance capital expenditures and $35 million to $40 million in growth capital expenditures in 2013.

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

Purchase of Property, Equipment and Software *(thousands of dollars unless otherwise noted)*	**2012**	2011
Growth expenditures	**49,253**	33,528
Facility maintenance	**35,723**	30,975
Deduct: capitalized interest	**(873)**	(195)
	84,103	64,308
Average U.S./Canadian dollar exchange rate	**0.9996**	0.9891

Net cash used in financing activities was $83.2 million in 2012 compared to $227.2 million in 2011. During 2012, Extendicare made cash distributions of $57.0 million, increased its investments held for self-insured liabilities by $31.6 million and increased restricted cash by $11.8 million. This was partially offset by debt issuances in excess of debt repayments and financing costs by $17.3 million as a result of the U.S. refinancing plan and convertible debt refinancing. In comparison, the 2011 activity included a larger repayment of debt as a result of the U.S. refinancing plan. For information on the change in long-term debt, refer to "Liquidity and Capital Resources – Long-term Debt".

Reconciliation of Cash Provided by Operating Activities to AFFO

The following table provides a reconciliation of the cash provided by operating activities to AFFO for the past eight quarters and the 2012 and 2011 years.[1]

	Q1		Q2		Q3		Q4		Year	
(millions of dollars)	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011	**2012**	2011
Cash provided by operating activities	**17.5**	29.0	**18.8**	28.1	**31.1**	42.0	**41.4**	7.7	**108.8**	106.8
Add (Deduct):										
Net change in operating assets and liabilities, including interest and taxes	**(6.1)**	(3.4)	**11.8**	9.2	**1.6**	(6.7)	**(1.9)**	23.4	**5.4**	22.5
Current tax on fair value adjustments, gain/loss on foreign exchange, financial instruments, asset impairment, disposals and other items	**21.3**	–	**(1.0)**	0.5	**(0.6)**	(0.9)	**0.1**	(2.4)	**19.8**	(2.8)
Net provisions and payments for self-insured liabilities	**(1.1)**	3.6	**(3.5)**	(4.7)	**(13.1)**	(22.1)	**0.8**	(7.0)	**(16.9)**	(30.2)
Exchangeable LP Unit distributions	**–**	0.7	**–**	0.6	**–**	0.7	**–**	0.2	**–**	2.2
Depreciation for FFEC	**(5.8)**	(5.9)	**(6.3)**	(5.6)	**(5.7)**	(5.8)	**(5.8)**	(6.1)	**(23.6)**	(23.4)
Additional facility maintenance capital expenditures[2]	**1.0**	1.2	**(1.0)**	(1.5)	**(3.0)**	(3.3)	**(9.1)**	(4.0)	**(12.1)**	(7.6)
Principal portion of government capital funding payments	**0.7**	0.6	**0.7**	0.7	**0.7**	0.7	**0.7**	0.6	**2.8**	2.6
Other	**(0.4)**	(0.2)	**–**	–	**0.2**	(0.1)	**0.6**	–	**0.4**	(0.3)
AFFO	**27.1**	25.6	**19.5**	27.3	**11.2**	4.5	**26.8**	12.4	**84.6**	69.8

(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

(millions of dollars unless otherwise noted)	**2012**	2011
Shareholders'/Unitholders' Equity		
Common Shares	**467.4**	–
REIT Units	–	453.1
Equity portion of convertible debentures	**5.6**	–
Contributed surplus	**0.1**	0.1
	473.1	453.2
Accumulated deficit at beginning of year	**(386.2)**	(287.5)
Net earnings (loss) for the year	**62.6**	(30.4)
Other/adjustment to prior year distribution of Assisted Living Concepts, Inc.	–	(0.4)
Dividends declared on Common Shares	**(17.9)**	–
Distributions declared on REIT Units	**(53.6)**	(67.9)
Accumulated deficit at end of year	**(395.1)**	(386.2)
Accumulated other comprehensive loss	**(23.4)**	(18.7)
Shareholders'/unitholders' equity	**54.6**	48.3
U.S./Canadian dollar exchange rate at end of year	**0.9949**	1.0170

Share/Unit Information *(thousands)*	**Feb. 28, 2013**	**Dec. 31, 2012**	Dec. 31, 2011
Common Shares/REIT Units (TSX symbol: EXE)[(1)]	**86,306.9**	**85,989.4**	84,121.5

(1) Closing market value per the TSX on February 28, 2013, was $7.65.

The closing rates used to translate assets and liabilities of the U.S. operations were 0.9949 at December 31, 2012, and 1.0170 at December 31, 2011. As a result of the stronger Canadian dollar at December 31, 2012, the assets of Extendicare's U.S. operations decreased by approximately $30.5 million, partially offset by a decrease in the liabilities of approximately $25.6 million, with the net change in foreign currency translation of $4.9 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 $2.7 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive loss.

DISTRIBUTIONS

In 2012, we generated AFFO of $84.6 million and declared monthly distributions of $0.07 per share/unit 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.

During 2011, monthly distributions to holders of REIT Units and Exchangeable LP Units of $0.07 per unit were declared totalling $70.1 million, of which $60.2 million was distributed in cash and $9.9 million was by way of units issued under a distribution reinvestment plan. A total of 1,125,603 REIT and Exchangeable LP units were issued during 2011 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 "2012 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 provides Extendicare with flexibility to repurchase Common Shares for cancellation until July 8, 2013, or on such earlier date as the Bid is complete. 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).

The Board has authorized the Bid because it believes that it is an appropriate use of Extendicare's available funds to purchase Common Shares when the market price of the Common Shares does not fully reflect their underlying value. Any Common Shares purchased under the Bid will increase the proportionate interest of, and may be advantageous to, all remaining securityholders.

The actual number of Common Shares purchased under the Bid and the timing of any such purchases will be at the discretion of the Board. Purchases of Common Shares will be made through the facilities of the TSX in accordance with its rules. Subject to the TSX's block purchase exception, on any trading day, purchases under the Bid will not exceed 46,897 Common Shares. The price that Extendicare will pay for any Common Shares purchased under the Bid will be the prevailing market price at the time of purchase and any Common Shares purchased by Extendicare will be cancelled.

LONG-TERM DEBT

Long-term debt, including current portion, was $1,132.2 million at December 31, 2012, and was net of $30.8 million of financing costs compared with $1,134.4 million at December 31, 2011. The current portion of long-term debt was $93.4 million at December 31, 2012. The current portion at the end of 2011 was $192.7 million and included the May 2012 CMBS Financing of $111.8 million (US$109.9 million) that was repaid in full in February 2012 as part of the debt refinancing plan. Further details on the debt refinancing are discussed under the heading "Overview – Significant 2012 Events and Developments – 2011/2012 Refinancing Plan".

The following summarizes the changes in the carrying amounts of long-term debt for the 2012 and 2011 years.

Continuity of Long-term Debt *(millions of dollars)*	**2012**	2011
Long-term debt at beginning of year, prior to financing costs	**1,156.6**	1,255.9
Issue of long-term debt		
Mortgages	**164.4**	390.5
2019 Debentures (net of $5.8 million allocated to equity)	**120.7**	–
PrivateBank loans	–	9.9
Construction loans	**37.7**	1.9
Notes payable/other	**1.1**	0.1
Redemption of 2013 Debentures at face value	**(91.8)**	–
Net issue (repayment) on the EHSI Credit Facility	**(44.9)**	35.7
Repayment of long-term debt	**(162.7)**	(551.2)
Revaluation of convertible debentures carried at fair value and accretion	**(4.7)**	0.6
Change due to period-end foreign exchange rate	**(13.4)**	13.2
	1,163.0	1,156.6
Financing costs at end of year	**(30.8)**	(22.2)
Long-term debt at end of year	**1,132.2**	1,134.4
Less: current portion	**(93.4)**	(192.7)
	1,038.8	941.7

Details of the components, terms and conditions of long-term debt are provided in *note 11* of the 2012 consolidated financial statements. Extendicare and its subsidiaries are in compliance with all of their respective financial covenants as at December 31, 2012.

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 $41.8 million of our long-term debt outstanding at December 31, 2012, excluding financing costs and equity allocation, was at fixed rates. The variable-rate debt related to US$8.1 million drawn on EHSI's Credit Facility and US$33.9 million drawn on the PrivateBank loans.

The continued refinancing of our U.S. debt during 2012 with government-insured mortgages at lower rates and with longer terms to maturity has further reduced our weighted average interest rates and terms to maturity from the 2011 year end levels.

The weighted average interest rate of our long-term debt was approximately 5.0% at December 31, 2012 (5.5% for our Canadian operations and 4.5% for U.S. operations), compared to 5.5% at December 31, 2011. The weighted average term to maturity of our long-term debt, including finance lease obligations, was 18.5 years as at December 31, 2012 (8.6 years for our Canadian operations and 28.8 years for our U.S. operations), compared to 14.5 years at December 31, 2011. Excluding our finance lease obligations, the weighted average term to maturity of our long-term debt was 18.9 years (7.2 years for our Canadian operations and 28.9 years for our U.S. operations).

Our consolidated interest coverage ratio based on our results for 2012 was 3.0 times (2011 year – 2.4 times). Interest coverage is defined as EBITDA divided by net interest.

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, 2012. 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)*	2013	2014	2015	2016	2017	After 2017	Total	Fair Value
Canadian Operations								
Convertible debentures (at face value)								
Fixed rate	–	113.9	–	–	–	126.5	240.4	247.6
Average interest rate	–	5.70%	–	–	–	6.00%	5.86%	
Long-term debt								
Fixed rate	44.1	17.5	11.3	17.7	28.3	125.5	244.4	260.0
Average interest rate	5.01%	4.30%	4.49%	4.49%	4.19%	6.41%	4.51%	
Finance lease obligations								
Fixed rate	4.6	5.0	5.3	5.7	6.1	83.6	110.3	131.2
Average interest rate	7.08%	7.09%	7.09%	7.09%	7.09%	7.09%	7.08%	
United States Operations(1)								
Long-term debt								
Fixed rate	13.2	9.5	9.9	10.2	10.7	472.1	525.6	554.3
Average interest rate	5.30%	4.41%	4.37%	4.32%	4.33%	4.34%	4.37%	
Variable rate	33.8	–	8.0	–	–	–	41.8	41.8
Average interest rate	6.00%	–	5.25%	–	–	–	5.86%	
Finance lease obligations								
Fixed rate	0.7	1.0	0.7	0.2	–	–	2.6	2.6
Average interest rate	5.51%	4.25%	4.85%	3.70%	–	–	5.51%	

(1) U.S. dollar denominated debt is translated to Canadian dollars at a rate of 0.9949.

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.

At December 31, 2012, the accrual for self-insured general and professional liabilities was $95.9 million compared to $79.4 million at the beginning of the year, representing an increase of $16.5 million. The current period provision, net of claims payments, increased the accrual by $16.9 million, with the balance of the change due to the impact of the stronger Canadian dollar and accretion of the discount.

Payments for self-insured liabilities were $23.9 million in 2012 and $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 has accounted for more than 50% of our provision for self-insured liabilities over the past two years. We had anticipated that following our exit from that state in mid-2012 our provision for self-insured liabilities would be reduced by approximately US$12 million per annum. However, an increase in claims in other states has offset this anticipated reduction.

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 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, 2012, management estimated that $21.9 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 $115.0 million at December 31, 2012, compared to $83.6 million at December 31, 2011. This increase of $31.4 million included cash injections of US$17.0 million into our captive insurance company during 2012 to ensure that it was adequately capitalized for regulatory purposes. Management believes there are sufficient cash resources to meet estimated current claims payment obligations.

OTHER CONTRACTUAL OBLIGATIONS

The table below provides summary information about the contractual obligations, other than long-term debt, as at December 31, 2012. 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 $95.9 million and $26.9 million, respectively, as at December 31, 2012, and also excludes our defined benefit pension plan obligations, which are described more fully below.

Other Contractual Obligations *(millions of dollars)*	Total	2013	2014	2015	2016	2017	After 2017
Canadian Subsidiary Operations							
Operating lease obligations	**8.9**	2.1	1.9	1.5	1.1	0.9	1.4
Purchase obligations	**24.7**	24.7	–	–	–	–	–
United States Subsidiary Operations(1)							
Operating lease obligations	**31.3**	5.2	4.9	4.3	4.1	3.9	8.9
Purchase obligations	**8.3**	8.3	–	–	–	–	–

(1) Obligations denominated in U.S. dollars are translated to Canadian dollars at a rate of 0.9949.

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, none of which had funding requirements as at December 31, 2012. The accrued benefit liability on our balance sheet as at December 31, 2012, was $35.8 million (December 31, 2011 – $35.2 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 fully funded with plan assets of $5.7 million and accrued benefit obligations of $7.6 million as at December 31, 2012 (December 31, 2011 – $5.6 million and $7.6 million, respectively). The accrued benefit obligations of the supplementary plan were $33.8 million as at December 31, 2012 (December 31, 2011 – $33.2 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 $42.7 million as at December 31, 2012 (December 31, 2011 – $40.0 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. 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 discussed in more detail under the heading "Overview – Significant 2012 Events and Developments – 2011/2012 Refinancing Plan", Extendicare has substantially completed the refinancing of approximately US$636 million of its U.S. long-term debt. Management anticipates refinancing this debt with approximately US$510 million of HUD-insured mortgages and US$126 million of cash on hand. As at December 31, 2012, we had closed on all but one, or US$3.6 million, of the HUD loans, which is anticipated to close by the end of the 2013 first quarter. Upon conclusion of the refinancing, EHSI anticipates closing on approximately US$510 million in HUD-insured mortgages with a weighted average all-in rate of approximately 4.33% and term to maturity of about 33 years, which is anticipated to reduce our interest costs by approximately US$20 million per annum. Together with the annual interest savings of approximately $5 million resulting from the December 2011 refinancing of $72.4 million of our Canadian debt, we anticipate total interest savings of approximately $25 million per annum.

As at December 31, 2012, EHSI had cash on hand of US$36.8 million and US$89.3 million available under the EHSI Credit Facility. Our Canadian operations had cash on hand of $34.2 million and available bank lines of $26.9 million at the end of December 2012. Upon completion of the new Sault Ste. Marie and Timmins projects, which is anticipated by the end of June 2013, the two existing centers in the area will close, resulting in a reduction of $6.0 million in the availability under the Canadian bank lines. As at December 31, 2012, we had approximately 55 unencumbered centers in the U.S. valued at an estimated US$250 million.

We are currently projected to spend up to in the range of $38 million to $44 million in facility maintenance capital expenditures and $35 million to $40 million in growth capital expenditures in 2013. As at December 31, 2012, EHSI and ECI had outstanding capital expenditure commitments totalling US$8.3 million and $24.7 million, respectively. ECI's commitments relate to the Timmins and Sault Ste. Marie construction projects.

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, which remains unchanged following the 2012 Conversion, necessitates raising funds through debt financings and the capital markets to fund strategic acquisitions and growth capital expenditures.

Related Party Transactions

On April 7, 2008, Tim Lukenda, the former President of Tendercare, was appointed President and Chief Executive Officer of Extendicare. Prior to its acquisition by EHSI, Mr. Lukenda owned an approximate 4.6% direct and indirect interest in Tendercare and received, directly or indirectly, on completion of the acquisition of Tendercare an equivalent percentage of the consideration paid by EHSI. EHSI completed the acquisition of Tendercare in October 2007 for $225.0 million (US$238.2 million), which was comprised of 29 skilled nursing centers and one inpatient rehabilitation hospital, for a total of 3,301 operational beds. As part of Mr. Lukenda's terms of employment, the employment contract provides a mechanism and process that effectively removes Mr. Lukenda from the decision-making process in situations where a conflict of interest may arise on any matter between Extendicare and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extendicare and its subsidiaries. EHSI and ECI also provide certain management services to two long-term care centers and operate under lease arrangements two long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

In connection with the purchase of Tendercare, the acquired working capital was subject to annual adjustments that occurred 90 days after the anniversary date of the Tendercare acquisition over a four-year period until January 2012. The working capital adjustments made have resulted in an increase of working capital with no impact to the consolidated statement of earnings and payments by EHSI of US$5.5 million. The fourth and final adjustment was paid in the 2012 third quarter.

In addition, in connection with the acquisition of LTC Professional in 2008, Tendercare's affiliated insurance company, consideration for the acquisition is to be adjusted annually based upon the actuarial liabilities determined at December 31st of each year through to 2012, with an option to extend it annually to 2015. In March of 2012, 2011, 2010 and 2009, ECI made annual settlements of US$0.1 million, US$1.3 million, US$1.5 million and US$2.2 million, respectively.

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 by ALC. LTC declined to remove EHSI as a party to the leases following the distribution of ALC by Extendicare to its shareholders in November 2006. Therefore, EHSI continues to be bound by the terms of the leases, while only ALC has a financial interest in the leased properties. A separation agreement entered into between Extendicare and ALC (the "Separation Agreement"), provides EHSI with indemnification against any claims arising as a result of ALC's non-performance relating to the LTC Master Leases. EHSI, being a party to the LTC Master Lease, has to approve any renewal options being exercised.

The LTC Master Leases provide for an initial 10-year term and three successive 10-year lease terms at the option of the lessee. There are no significant economic penalties if the renewal options are not exercised. The aggregate minimum rental payments for the 2013 calendar year are US$11.8 million and will increase by 2% for the remaining calendar year of 2014. Annual minimum rent during any renewal term will increase by a minimum of 2% over the minimum rent of the immediately preceding year.

In its 2012 third quarter 10-Q filing with the U.S. Securities and Exchange Commission (the "SEC"), ALC stated that it may not meet its financial covenants under its line of credit. On January 7, 2013, ALC filed a Form 8-K with the SEC stating that on December 31, 2012, it had entered into a waiver and amendment agreement with its lenders that, among other things: (i) waived existing alleged defaults under its line of credit; (ii) waived any non-compliance of the financial covenants that may occur on or before December 31, 2012 and for the period ending March 31, 2013; (iii) requires ALC to provide its lenders, on or before March 31, 2013, a fully executed agreement that provides for the repayment of all obligations under the line of credit within a reasonable amount of time, with such transaction to close by August 15, 2013; and (iv) requires ALC to obtain not less than US$15.0 million from a new credit facility, sale of unencumbered assets, or otherwise, on or before July 2, 2013.

On February 25, 2013, ALC announced that it has entered into a definitive agreement with affiliates of TPG Capital, L.P. (collectively "TPG"), a global private investment firm, whereby TPG has agreed to acquire all of the outstanding Class A and B shares of ALC for cash. The closing of the transaction is conditional upon, among other things, affirmative votes of ALC's shareholders, the receipt of customary regulatory approvals and other customary closing conditions. However, the transaction is not subject to a financing condition. At this time, and based upon information provided in ALC's 8-K filing dated February 26, 2013, 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. No details were provided in the announcement with respect to ALC line of credit.

Based upon a legal and financial assessment of risk associated with the LTC Master Leases, Extendicare believes that its maximum exposure, which is dependant on a number of factors, is less than US$4.0 million for the remaining term of the lease. However, management believes that this potential liability is not probable; consequently, no provision has been recognized as at December 31, 2012.

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 that 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 74% in 2012), 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, 2012, 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 action, 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 its residents, we are continually allocating increased resources to ensure compliance with applicable 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 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

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 flow. 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 be continued 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, the LTC Act 2007, which was proclaimed into force in July 2010, provides for, among other things: new licensing procedures that include more rigorous standards for license review (including public hearings); fixed license terms for up to 25 years, depending on bed classifications (licenses can be revoked in cases of 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 three years' notice before the end of the term of a license as to whether a new license will be issued.

In July 2007, the Ontario government initiated plans to redevelop 35,000 older long-term care beds in five phases over the next 10 to 15 years, and provide qualified applicants with a 25-year construction funding subsidy. ECI currently owns 23 nursing centers with 3,572 class "C" beds and leases one center with 95 interim beds that require redevelopment to meet the new standards. ECI and other operators continue to express concerns about the adequacy of the Ontario government's construction funding subsidy of $13.30 per bed per day (see "Ontario Redevelopment Program" under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada").

Risks Related to Litigation

LIABILITY, INSURANCE AND LITIGATION

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 basis 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 reserves of the Company's 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 professional liability and general 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 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.

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 of ALC in 2006, Extendicare and ALC entered into a number of transactions and agreements, including the Separation Agreement, a number of transitional service agreements, and a number of operating leases and purchase 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 until the end of 2014. Based upon a legal and financial assessment of risk associated with the LTC Master Leases, Extendicare believes that its maximum exposure, which is dependant on a number of factors, is less than US$4.0 million for the remaining term of the lease. However, management believes that this potential liability is not probable; consequently, no provision has been recognized as at December 31, 2012.

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 of ALC to Extendicare's shareholders 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 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 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 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 and Foreign Currency Exposure

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 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.

Extendicare's credit facility with RBC (the "RBC Credit Facility"), which consists of a $70.0 million working capital line and a US$10.2 million letter of credit facility, is due on demand and is primarily used to back letters of credit that renew annually. The availability under the working capital line was $26.9 million at December 31, 2012, with letters of credit issued of $43.1 million and US$10.2 million. In February 2013, the RBC Credit Facility was amended to reduce the U.S. dollar letter of credit facility, along with the corresponding letter of credit that was issued, to US$7.8 million from US$10.2 million. In addition, upon completion of the new Sault Ste. Marie and Timmins projects, which is anticipated by the end of June 2013, the two existing centers in the area will close, resulting in a reduction of the $70.0 million working capital line by $6.0 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 affect 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, 2012. 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 $41.8 million of the Company's total long-term debt outstanding at December 31, 2012, 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.

FOREIGN CURRENCY RATE FLUCTUATIONS

The majority of the Company's operations are conducted in the United States and the financial position and results are denominated in U.S. dollars. The U.S. operations accounted for 64.2% of our consolidated revenue from continuing operations and 60.8% of our adjusted funds from operations in 2012. 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 distributions 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. Prior to June 2011, the Company had FCFCs in place. 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 capital lease arrangements with options to purchase, approximately 98% of its senior care centers, excluding those under management contracts. 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 income and funds available for distribution of the Company 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. This illiquidity will tend to limit 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 not as old as those owned by the Company, or that may appear more modern and, therefore, may be more attractive to potential patients and residents. Over the next 10 to 15 years, ECI will be required to redevelop 23 class "C" long-term care centers in accordance with the Government of Ontario's redevelopment program (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", "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, as well as excluding the line item "loss (gain) from asset impairment, disposals and other items". Management believes that certain lenders, investors and analysts use 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 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 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, 2012, 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 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 79% of its revenue from services provided under various federal or state medical assistance programs during 2012 (2011 – 80%). 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 a 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 2012, revenue from provincial programs represented approximately 66% of ECI's nursing center operations, and approximately 97% 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, 2012, receivables from government agencies represented approximately 70% of the total receivables. Management does not believe there is any significant credit risk associated with these government agencies other than possible funding delays. Receivables from other than 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, 2012, was associated with the U.S. operations. The allowance for doubtful accounts for current accounts receivable totalled $18.5 million and $16.7 million at December 31, 2012 and 2011, respectively. Days of revenue outstanding were 39 days at December 31, 2012 compared to 38 days as at December 31, 2011.

At December 31, 2012, EHSI had $23.7 million (US$23.8 million) in Medicare and Medicaid settlement receivables, compared to $33.5 million (US$32.9 million) at the end of 2011. There was no allowance on these receivable balances. It is expected that $12.3 million (US$12.3 million) will be substantially collected within one year and is included in accounts receivable as a current asset, compared to $10.4 million (US$10.2 million) at December 31, 2011. 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.

The 2011 CMS Final Rule announcement in July 2011 triggered the necessity for impairment testing of our U.S. operations in the 2011 third quarter. This resulted in the recognition of a pre-tax impairment loss of $54.0 million (US$53.9 million), of which $22.4 million (US$22.3 million) related to goodwill and the balance to property and equipment.

In the 2012 third quarter, 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.

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 2012 third quarter impairment test on the U.S. operations, the key assumptions used to determine the recoverable amounts were as follows: capitalization rates of 12.6% for nursing centers and 8.6% for assisted living centers; annual maintenance capital expenditures per bed of US$300; 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 for the U.S. operations in the 2012 third quarter, a 10-basis point increase in the capitalization rate would cause a $0.1 million increase in goodwill impairment, assuming all other variables remained constant. As for our Canadian operations, an impairment assessment was performed at the end of 2012, which determined that there was no impairment of goodwill. A 10-basis point increase in the capitalization rate applied for the Canadian operations impairment test would have had no impact on the results.

DECOMMISSIONING PROVISIONS

Management has determined that future costs could be incurred for possible asbestos remediation of the Company's pre-1980 constructed centers. Though 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.

As at December 31, 2012, the decommissioning provision, which related to asbestos remediation, was $26.9 million compared to $26.1 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 2012.

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 not discounted and are included within accrued liabilities as a current liability. 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 from one reporting period to another.

At December 31, 2012, the accrual for self-insured general and professional liabilities was $95.9 million compared to $79.4 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, 2012, would have impacted our net earnings by approximately $1.0 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 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. Deferred tax assets and liabilities are measured using tax rates (enacted or substantially enacted at the balance sheet 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, 2012, there were capital losses available for Canadian income tax purposes of $21.5 million (2011 – $21.7 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 $2.9 million (2011 – $2.9 million).

New Accounting Policies Adopted

The following new accounting policy was adopted in 2012.

Financial Instruments – Disclosures: In October 2010, the IASB issued amendments to IFRS 7 "Disclosures – Transfers of Financial Assets", which was effective for annual periods beginning on or after January 1, 2012. The amendments did not have a material impact on the financial statements, because of the nature of the Company's operations and the types of financial assets that it holds.

Future Change in Accounting Policies

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning on or after January 1, 2013, and have not been applied in preparing the financial results for the year ended December 31, 2012. Those that are relevant for Extendicare are not expected to have a significant effect on the consolidated financial statements and the Company does not plan to early adopt any of them.

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, 2012, 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, 2012, 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 framework and criteria established by the Committee of Sponsoring Organizations of the Treadway Commission. 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, 2012.

Additional Information

Additional information about Extendicare, including the Annual Information Form, 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 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.

(signed)

Timothy L. Lukenda
President and Chief Executive Officer

(signed)

Douglas J. Harris
Senior Vice President and
Chief Financial Officer

March 20, 2013

Independent Auditors' Report

To the Shareholders of Extendicare Inc.

We have audited the accompanying consolidated financial statements of Extendicare Inc. ("Extendicare" or the "Company"), formerly "Extendicare Real Estate Investment Trust", which comprise the consolidated statements of financial position as at December 31, 2012, and December 31, 2011, and the consolidated statements of earnings (loss), comprehensive income (loss), changes in equity, and cash flows for the years ended December 31, 2012 and 2011, 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, 2012, and December 31, 2011, and the results of its operations and its cash flows for the years ended December 31, 2012 and 2011, in accordance with International Financial Reporting Standards.

(signed KPMG LLP)

Chartered Accountants,
Licensed Public Accountants

Toronto, Canada
March 20, 2013

Consolidated Statements of Financial Position

(in thousands of Canadian dollars)

As at December 31	*notes*	**2012**	2011
Assets			
Current assets			
Cash and short-term investments		**71,398**	80,018
Restricted cash	*11*	**28,680**	16,848
Accounts receivable	*5*	**209,518**	222,707
Income taxes recoverable		**4,149**	8,223
Other current assets		**31,408**	32,279
Total current assets		**345,153**	360,075
Non-current assets			
Property and equipment	*6*	**1,181,596**	1,192,913
Goodwill and other intangible assets	*7*	**82,793**	87,269
Other assets	*8*	**176,457**	154,695
Deferred tax assets	*21*	**21,917**	35,752
Total non-current assets		**1,462,763**	1,470,629
Total Assets	*27*	**1,807,916**	1,830,704
Liabilities and Equity			
Current liabilities			
Accounts payable and accrued liabilities	*9*	**238,421**	266,934
Income taxes payable		**9,377**	10,519
Long-term debt	*11*	**93,448**	192,698
Provisions	*10*	**21,888**	24,408
Total current liabilities		**363,134**	494,559
Non-current liabilities			
Long-term debt	*11*	**1,038,787**	941,742
Provisions	*10*	**100,893**	81,120
Other long-term liabilities	*12*	**48,025**	49,638
Deferred tax liabilities	*21*	**202,417**	215,326
Total non-current liabilities		**1,390,122**	1,287,826
Total liabilities	*27*	**1,753,256**	1,782,385
Unit capital	*13*	**–**	453,150
Share capital	*13*	**467,463**	–
Equity portion of convertible debentures	*11*	**5,573**	–
Contributed surplus		**48**	81
Accumulated deficit		**(395,024)**	(386,174)
Accumulated other comprehensive loss		**(23,400)**	(18,738)
Shareholders'/unitholders' equity		**54,660**	48,319
Total Liabilities and Equity		**1,807,916**	1,830,704

See accompanying notes to consolidated financial statements.

Subsequent events *(notes 11 and 22)*.

Commitments and contingencies *(note 22)*.

Approved by the Board

(signed)

Mel Rhinelander
Chairman

(signed)

Timothy L. Lukenda
President and Chief Executive Officer

Consolidated Statements of Earnings (Loss)

(in thousands of Canadian dollars except per share amounts)

Years ended December 31	*notes*	**2012**	2011
CONTINUING OPERATIONS			
Revenue			
Nursing and assisted living centers			
United States		**1,259,858**	1,355,289
Canada		**550,302**	525,831
Home health care – Canada		**170,343**	165,030
Health technology services – United States		**25,453**	19,120
Outpatient therapy – United States		**13,229**	13,750
Rent, management, consulting and other services		**18,228**	15,062
Total revenue	*15*	**2,037,413**	2,094,082
Operating expenses		**1,780,019**	1,813,792
Administrative costs		**63,155**	69,155
Lease costs		**10,986**	10,999
Total expenses	*16*	**1,854,160**	1,893,946
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items		**183,253**	200,136
Depreciation and amortization		**76,805**	76,577
Loss from asset impairment, disposals and other items	*17*	**7,930**	62,496
Results from operating activities		**98,518**	61,063
Interest expense		**65,306**	89,634
Accretion of decommissioning provisions		**1,694**	1,606
Other accretion		**608**	423
Distributions on Exchangeable LP Units		**–**	2,179
Loss on foreign exchange and financial instruments		**1,103**	–
Finance costs		**68,711**	93,842
Interest revenue		**3,565**	4,322
Fair value adjustments		**4,823**	6,023
Gains on foreign exchange and financial instruments		**–**	553
Finance income		**8,388**	10,898
Net finance costs	*18*	**60,323**	82,944
Earnings (loss) before income taxes		**38,195**	(21,881)
Income tax expense (recovery)			
Current		**5,178**	28,280
Deferred		**5,394**	(14,838)
Total income tax expense	*21*	**10,572**	13,442
Earnings (loss) from continuing operations		**27,623**	(35,323)
DISCONTINUED OPERATIONS			
Earnings from discontinued operations, net of income taxes	*20, 21*	**35,033**	4,927
Net earnings (loss) attributable to shareholders/unitholders of the company		**62,656**	(30,396)
Basic Earnings per Share			
Earnings from continuing operations	*19*	**0.32**	
Net earnings	*19*	**0.74**	
Diluted Earnings per Share			
Earnings from continuing operations	*19*	**0.32**	
Net earnings	*19*	**0.68**	

See accompanying notes to consolidated financial statements.

Consolidated Statements of Comprehensive Income (Loss)

(in thousands of Canadian dollars)

Years ended December 31	*notes*	**2012**	2011
Net earnings (loss)		**62,656**	(30,396)
Other comprehensive income (loss), net of income taxes			
Unrealized gain on available-for-sale securities	*14*	**1,505**	59
Reclassification of realized gain on available-for-sale securities to earnings	*14*	**(315)**	(115)
Defined benefit plan actuarial loss, net of tax		**(985)**	(3,280)
Net change in foreign currency translation adjustment	*14*	**(4,867)**	5,373
Other comprehensive income (loss), net of taxes		**(4,662)**	2,037
Total comprehensive income (loss)		**57,994**	(28,359)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

(in thousands of Canadian dollars)

Years ended December 31	notes	2012	2011
Share/unit capital			
Unit capital, beginning of year		**453,150**	421,213
DRIP		**7,112**	9,245
Conversion from Exchangeable LP Units		**–**	22,684
Conversion from convertible debentures		**–**	8
2012 Conversion	*1, 13*	**(460,262)**	–
Unit capital, end of year		**–**	453,150
Share capital, beginning of year		**–**	–
DRIP		**7,275**	–
Purchase of shares for cancellation in excess of book value		**(74)**	–
2012 Conversion	*1, 13*	**460,262**	–
Share capital, end of year		**467,463**	–
Balance at end of year		**467,463**	453,150
Equity portion of convertible debentures			
Balance at beginning of year		**–**	–
Issuance of convertible debentures		**5,573**	–
Balance at end of year		**5,573**	–
Contributed surplus			
Balance at beginning of year		**81**	81
Purchase of shares for cancellation in excess of book value		**(33)**	–
Balance at end of year		**48**	81
Accumulated deficit			
Balance at beginning of year		**(386,174)**	(287,525)
Net earnings (loss)		**62,656**	(30,396)
Dividends/distributions declared		**(71,497)**	(67,921)
Other		**(9)**	(332)
Balance at end of year		**(395,024)**	(386,174)
Accumulated other comprehensive loss			
Balance at beginning of year		**(18,738)**	(20,775)
Other comprehensive income (loss):			
Foreign currency translation differences for foreign operations		**(4,867)**	5,373
Net change in fair value of available-for-sale financial assets, net of tax		**1,505**	59
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of tax		**(315)**	(115)
Defined benefit plan actuarial losses, net of tax		**(985)**	(3,280)
Total other comprehensive income (loss)		**(4,662)**	2,037
Balance at end of year		**(23,400)**	(18,738)
Shareholders'/unitholders' equity		**54,660**	48,319

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(in thousands of Canadian dollars)

Years ended December 31	**2012**	2011
Operating Activities		
Net earnings (loss)	**62,656**	(30,396)
Adjustments for:		
Depreciation and amortization	**76,805**	76,658
Accrual for self-insured liabilities in provisions	**40,807**	65,266
Payments for self-insured liabilities in provisions	**(23,933)**	(35,103)
Deferred taxes	**5,263**	(14,838)
Current taxes	**26,729**	31,316
Loss from asset impairment, disposals and other items	**7,930**	62,496
Gain from asset disposals from discontinued operations	**(56,453)**	–
Net finance costs	**60,323**	82,944
Interest capitalized	**(873)**	(195)
Other	**(406)**	399
	198,848	238,547
Net change in operating assets and liabilities		
Accounts receivable	**21,111**	(10,545)
Other current assets	**759**	(11,210)
Accounts payable and accrued liabilities	**(31,701)**	(4,525)
	189,017	212,267
Interest paid	**(60,276)**	(83,531)
Interest received	**3,509**	4,278
Income taxes paid	**(23,463)**	(26,235)
Net cash from operating activities	**108,787**	106,779
Investing Activities		
Purchase of property, equipment and software	**(84,103)**	(64,308)
Purchase of nursing center, net of cash acquired	**–**	(7,299)
Net proceeds from dispositions	**56,323**	4,805
Increase of other assets	**(5,363)**	(1,104)
Net cash from investing activities	**(33,143)**	(67,906)
Financing Activities		
Issue of long-term debt, excluding line of credit	**329,720**	402,327
Repayment of long-term debt, excluding line of credit	**(254,468)**	(551,250)
Issue on line of credit	**63,964**	81,195
Repayment on line of credit	**(108,846)**	(45,474)
Increase in restricted cash	**(11,832)**	(6,753)
Increase in investments held for self-insured liabilities	**(31,603)**	(21,053)
Dividends/distributions paid	**(56,980)**	(58,375)
Financing costs	**(13,101)**	(28,315)
Other	**(4)**	455
Net cash from financing activities	**(83,150)**	(227,243)
Decrease in cash and short-term investments	**(7,506)**	(188,370)
Cash and short-term investments at beginning of year	**80,018**	267,759
Foreign exchange gain (loss) on cash held in foreign currency	**(1,114)**	629
Cash and short-term investments at end of year	**71,398**	80,018

See accompanying notes to consolidated financial statements.

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

Notes to Consolidated Financial Statements

Years ended December 31, 2012 and 2011

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Years ended December 31, 2012 and 2011

(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 13)*. 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 March 20, 2013.

(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 15);*
- valuation of accounts receivable *(notes 5 and 24(a));*
- determination of the recoverable amount of cash generating units (CGUs) subject to an impairment test *(notes 7 and 17);*
- valuation of decommissioning provisions *(note 10);*
- valuation of self-insured liabilities *(note 10);*
- assessment of contingencies *(note 22);*
- valuation of financial assets and liabilities *(note 24(b));*
- valuation of share appreciation rights liabilities *(note 12);* and
- accounting for tax uncertainties and the tax rates used for valuation of deferred taxes *(note 21)*.

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)ii*. 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

i. 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.

ii. 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.

On the Transition Date, the Company determined the individual fair value of each of its centers. Based upon this detailed review, certain centers were restated to reflect their fair value as of January 1, 2010. The remaining centers were not selected for revaluation either due to their economic life being limited or where existing and anticipated future cash flows did not warrant the revaluation of the center.

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.

i. 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.

ii. 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 rate 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

i. 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)*.

ii. 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 results from operating activities in net earnings.

i. 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.

ii. 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 contract 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 either available for sale or held to maturity. 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

i. 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 that 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.

ii. 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.

iii. 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.

iv. 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) and the "Accrued Distributions" 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 are comprised of estimated self-insured liabilities, decommissioning provisions and other legal claims and obligations.

i. 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 upon the projected timing of future payment obligations.

ii. Decommissioning provisions

Management has determined that future costs could be incurred for possible asbestos remediation of the Company's pre-1980 constructed centers. Though 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.

iii. 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) Exchangeable LP Units

Prior to November 10, 2011, the outstanding Class B limited partnership units (Exchangeable LP Units) of Extendicare Limited Partnership (Extendicare LP) contained features that were economically equivalent to the REIT Units. These units were presented as a liability of the REIT and distributions to holders of Exchangeable LP Units were presented as a finance cost. On November 10, 2011, the remaining Exchangeable LP Units were automatically converted into REIT Units and the carrying value of the remaining Exchangeable LP Units was reclassified to unitholders' equity.

(o) Financial Instruments

i. 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 five classifications being: held-to-maturity financial assets, loans and receivables, financial assets at FVTPL, AFS and financial liabilities. Following 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 designated 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 rate 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.

Prior to their conversion into REIT Units, the Exchangeable LP Units were also designated as financial liabilities valued at FVTPL; therefore, they were valued at fair value initially and on an ongoing basis, with changes in fair value recognized in net earnings as part of finance costs. The carrying amount upon conversion into REIT Units was reclassified to and accounted for as unitholders' equity.

Summary of financial instruments and classification

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

Below is a classification summary of the Company 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
Investments held for self-insured liabilities – Held to maturity	Held to maturity	Amortized cost
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
Exchangeable LP Units	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.

For financial instruments reported at fair value, the Company uses the fair value hierarchy as follows:

Level 1 – quoted 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.

Where possible, the Company will use the highest of the fair value hierarchy levels.

ii. 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 11)*; distributions on the Exchangeable LP Units; losses on the change in fair value of financial liabilities designated as FVTPL (refer to *note 3(o)i)*; 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.

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)i)*, 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. There were no deferred taxes recorded for the change in fair value of the Exchangeable LP Units.

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. Future Changes in Accounting Policies

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning on or after January 1, 2013, and have not been applied in preparing these consolidated financial statements. Those that are relevant for Extendicare are not expected to have a significant effect on the consolidated financial statements and the Company does not plan to early adopt any of them.

5. Accounts Receivable

	2012	2011
Trade receivables	**165,572**	186,938
Retroactive rate accruals	**25,903**	35,374
Other receivables	**29,438**	23,472
Total Receivables – Net of Allowance *(note 24(a))*	**220,913**	245,784
Less: non-current portion *(note 8)*	**(11,395)**	(23,077)
Accounts Receivable	**209,518**	222,707

6. Property and Equipment

	Land & Land Improvements	Buildings	Furniture & Equipment	Leasehold Improvements	Construction in Progress	Total
Cost or deemed cost						
January 1, 2011	153,858	1,114,340	143,564	8,601	17,470	1,437,833
Additions	2,554	15,163	14,714	295	50,400	83,126
Government grants	–	–	–	–	(12,600)	(12,600)
Interest capitalized	–	–	–	–	195	195
Transfer to assets held for sale	348	3,202	(324)	–	–	3,226
Disposals	(397)	(7,363)	(629)	–	–	(8,389)
Write-off of fully-depreciated assets	–	(4,142)	(2,357)	(3)	–	(6,502)
Impairment loss *(note 7)*	–	(31,657)	–	–	–	(31,657)
Transfer from construction-in-progress	2,337	28,676	5,839	(2,547)	(34,305)	–
Reclass and other	5,483	(5,851)	(2,903)	2,494	(2,486)	(3,263)
Effect of movements in exchange rates	2,953	17,061	2,516	135	96	22,761
December 31, 2011	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 *(notes 7 and 17)*	**–**	**(17,796)**	**–**	**–**	**–**	**(17,796)**
Reversal of impairment loss *(note 7)*	**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**
Accumulated depreciation						
January 1, 2011	5,491	151,078	70,943	3,665	–	231,177
Additions	5,364	40,119	17,071	7,446	–	70,000
Transfer to assets held for sale	26	155	(411)	–	–	(230)
Disposals	(19)	(3,588)	(366)	33	–	(3,940)
Write-off of fully-depreciated assets	–	(4,142)	(2,357)	(3)	–	(6,502)
Reclass and other	1,575	4,902	(2,112)	(6,531)	–	(2,166)
Effect of movements in exchange rates	266	1,718	1,417	77	–	3,478
December 31, 2011	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**
Carrying amounts						
At December 31, 2011	154,433	939,187	76,235	4,288	18,770	1,192,913
At December 31, 2012	**147,955**	**892,993**	**74,243**	**3,717**	**62,688**	**1,181,596**

The cost of assets included in property and equipment under finance leases was $87.0 million (December 31, 2011 – $100.3 million) with accumulated depreciation of $22.2 million (December 30, 2011 – $20.6 million) *(note 11)*.

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 of the lease is US$15.0 million with a minimum rent escalation of 2.5% in year five, and 3.0% 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 17)*.

In March 2011, EHSI purchased a 100-bed skilled nursing center in Ohio, which EHSI had previously leased, for cash of US$7.5 million.

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 of December 31, 2012, all forgivable loans in respect of these projects have been received. The forgivable government loans received are 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 is completed and are 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% (2011 – 6.39%). Interest capitalized in 2012 was $0.9 million (2011 – $0.2 million).

7. Goodwill and Other Intangible Assets

	2012	2011
Goodwill		
Balance at beginning of year	**73,323**	93,820
Additions	–	349
Disposals	**(418)**	–
Impairment loss	**(1,080)**	(22,357)
Effect of movements in exchange rates	**(1,322)**	1,511
Balance at end of year	**70,503**	73,323
Other Intangible Assets		
Gross carrying value at beginning of year	**36,547**	32,543
Additions	**4,365**	1,248
Write-off of fully amortized assets	**(168)**	(73)
Reclass	**930**	–
Effect of movements in exchange rates	**(683)**	2,829
Gross carrying value at end of year	**40,991**	36,547
Accumulated amortization at beginning of year	**(22,601)**	(16,091)
Amortization	**(6,751)**	(6,657)
Write-off of fully amortized assets	**168**	73
Effect of movements in exchange rates	**483**	74
Accumulated amortization at end of year	**(28,701)**	(22,601)
Net carrying value	**12,290**	13,946
Goodwill and Other Intangible Assets	**82,793**	87,269

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 17)*.

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 20)*.

In July 2011, the Centers for Medicare and Medicaid Services (CMS) announced Medicare rate reductions in conjunction with changes in the assessment process and the elimination of group therapy that reduced Medicare funding effective October 1, 2011. As a result of this announcement, EHSI tested each of its centers for impairment in the reported values of both property and equipment, and goodwill. Based on the computations performed in the 2011 third quarter, EHSI recognized a pre-tax impairment loss of $54.0 million (US$53.9 million), of which $22.4 million (US$22.3 million) related to goodwill, and $31.7 million (US$31.6 million) to property and equipment *(note 17)*.

In the 2012 third quarter, 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 17)*.

Goodwill of $0.3 million resulted from the purchase of three clinics by EHSI in 2011. Goodwill for these clinics was allocated on the same basis as other CGUs and the goodwill policy applied. These were assessed at December 31, 2012, and there was no impairment.

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 $36.6 million and $8.4 million, respectively (December 31, 2011 – $34.8 million and $12.6 million).

8. Other Assets

	2012	2011
Investments held for self-insured liabilities: available-for-sale securities, at fair value	**115,025**	83,608
Notes, mortgages and amounts receivable	**50,037**	48,010
Medicare and Medicaid settlement receivables, less allowance of nil *(note 5)*	**11,395**	23,077
	176,457	154,695

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 $18.9 million (US$19.0 million) (December 31, 2011 – $15.2 million, or US$14.9 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, 2012, all investments were categorized as available for sale.

	2012	2011
Fixed income securities, with maturities due:		
In one year or less	**6,194**	17,760
After 1 year through 5 years	**11,010**	36,743
After 5 years through 10 years	–	2,323
	17,204	56,826
Cash and money market funds	**88,366**	26,782
Equities	**9,455**	–
	115,025	83,608

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

	2012	2011
U.S. Treasuries	**17,204**	13,227
U.S. agency bonds	–	17,630
Corporate bonds	–	25,969
Equities	**9,455**	–
	26,659	56,826

Notes, Mortgages and Amounts Receivable

Included in notes, mortgages and amounts receivable were $34.3 million (December 31, 2011 – $37.2 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 over a 20-year period. As each center was opened, a receivable from the government was recorded based on applying a discount rate equivalent to the yield on a 20-year Ontario government bond. The amounts were discounted at rates ranging from 5.3% to 6.5% and were also 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, 2012, totalled $23.7 million (December 31, 2011 – $33.5 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 $11.4 million (December 31, 2011 – $23.1 million) were reported in other assets.

9. Accounts Payable and Accrued Liabilities

	2012	2011
Accounts payable	**35,508**	42,241
Accrued liabilities	**202,913**	224,693
Total	**238,421**	266,934

10. Provisions

	Accrual for Self-insured Liabilities	Decommissioning Provisions	Liabilities Assumed from Crown Life	Total
January 1, 2011	46,548	24,247	5,601	76,396
Provisions recorded	65,266	–	–	65,266
Provisions used	(35,103)	(167)	(3,204)	(38,474)
Provisions reversed	–	–	(2,397)	(2,397)
Accretion	792	1,604	–	2,396
Effect of movements in exchange rates	1,920	421	–	2,341
December 31, 2011	79,423	26,105	–	105,528
Non-current	55,015	26,105	–	81,120
Current	24,408	–	–	24,408
December 31, 2011	79,423	26,105	–	105,528
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**
Non-current	**74,042**	**26,851**	**–**	**100,893**
Current	**21,888**	–	**–**	**21,888**
December 31, 2012	**95,930**	**26,851**	**–**	**122,781**

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 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)ii)*.

Liabilities Assumed from Crown Life

Under the June 2007 Crown Life share sale agreement with The Canada Life Assurance Company (Canada Life), Extendicare was responsible for specified contingent claims against Crown Life, and had accrued provisions for potential settlements that were secured by letters of credit. Settlement on all of the remaining claims was reached during 2011, resulting in the release of the remaining excess provisions of $2.4 million in 2011 and the elimination of the letters of credit.

11. Long-term Debt

	Interest Rate	Year of Maturity		**2012**	2011
			US$	C$	C$
EHSI *(payable in US$)*					
HUD mortgages	3.20% – 5.75%	2022 – 2047	*524,250*	**521,576**	402,060
May 2012 CMBS Financing	6.6525%	2012	–	–	111,755
Line of credit	variable	2015	*8,100*	**8,059**	53,901
PrivateBank loans	variable	2013	*33,947*	**33,774**	35,076
Finance lease obligations	5.24% – 6.56%	2015 – 2016	*2,653*	**2,640**	15,075
Notes payable	0% – 7.5%	2013 – 2014	*4,068*	**4,048**	9,238
			573,018	**570,097**	627,105
Financing costs			*(19,331)*	**(19,234)**	(15,591)
			553,687	**550,863**	611,514
Extendicare Inc. and Canadian Subsidiaries *(payable in C$)*					
Convertible Unsecured Subordinated Debentures	6.0%	2019		**120,915**	–
Convertible Unsecured Subordinated Debentures	5.7%	2014		**117,325**	116,778
Convertible Unsecured Subordinated Debentures	7.25%	2013		–	97,531
CMHC mortgages	2.22% – 7.7%	2013 – 2037		**189,209**	166,308
Non-CMHC mortgages	5.75%	2013		**15,533**	15,912
Finance lease obligations	6.41% – 7.19%	2026 – 2028		**110,343**	114,667
Construction loans	5.558% – 5.637%	2038		**39,652**	18,288
				592,977	529,484
Financing costs				**(11,605)**	(6,558)
				581,372	522,926
Total debt net of financing costs				**1,132,235**	1,134,440
Less: current portion				**93,448**	192,698
				1,038,787	941,742

EHSI Debt

2012 REFINANCING PLAN

As at December 31, 2012, EHSI has substantially completed the refinancing of approximately US$636 million of debt with approximately US$510 million of mortgages insured by the U.S. Department of Housing and Urban Development (HUD) and US$126 million of cash on hand. As at December 31, 2012, EHSI had closed on 68 HUD loans totalling US$506.3 million in connection with this refinancing. EHSI anticipates obtaining and closing on the remaining HUD commitment with a principal balance of US$3.6 million by the end of the first quarter of 2013. Upon conclusion of this refinancing, EHSI anticipates that the new HUD-insured mortgages will have a weighted average rate of approximately 4.33%, inclusive of mortgage insurance premiums (MIP), and term to maturity of about 33 years.

The debt being refinanced related to EHSI's commercial mortgage backed securitization (CMBS) financings due in March 2012 (the "March 2012 CMBS Financing") and in May 2012 (the "May 2012 CMBS Financing"), mortgage financing from Sovereign Bank and other lenders (the "Sovereign Loans"), and approximately US$17.5 million of advances on EHSI's US$70.0 million credit facility. The Sovereign Loans, the March 2012 CMBS Financing and May 2012 CMBS Financing were fully repaid in June 2011, November 2011 and February 2012, respectively.

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 October 2013. EHSI already had approximately US$27 million of HUD loans issued prior to this refinancing plan. EHSI is in the process of securing additional HUD loans to refinance existing debt that would result in utilizing approximately US$574 million of its US$585.0 million overall limit before it expires in October 2013. As at December 31, 2012, EHSI had approximately 55 unencumbered centers valued at an estimated US$250 million, none of which are part of the additional HUD financings yet to be completed.

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 17)*.

HUD MORTGAGE LOANS

As at December 31, 2012, EHSI had a total of 76 HUD-insured loans secured by 76 skilled nursing centers and one assisted living facility. These mortgages have an average remaining term of 31 years with fixed interest rates ranging from 3.20% to 5.75% and representing a weighted average interest rate of 4.35%. Depending on the mortgage agreement, prepayments are allowed only after 12 months or 24 months from the inception of the mortgage, and thereafter subject to prepayment penalties of 9% or 8%, respectively, of the remaining principal balances. The prepayment penalties decrease each subsequent year by 1% until no penalty is required. As at December 31, 2012, US$401.3 million of the mortgages could not be prepaid, and US$123.0 million were subject to prepayment fees ranging from 3% to 9%.

All HUD-insured mortgage loans 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 mortgage insurance premiums, property taxes, insurance and for capital replacements expenditures. As at December 31, 2012, EHSI had escrow reserve funds of US$7.7 million with the loan servicer that are reported within other current assets, and replacement reserve funds of US$9.5 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, 2012, restricted cash for working capital was US$18.7 million.

CMBS FINANCINGS

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.

The March 2012 CMBS Financing was completed on March 6, 2007, for US$90.0 million. It had a five-year term that matured on March 11, 2012, and had a fixed interest rate of 6.79%, with interest-only monthly payments for the first two years, and monthly principal and interest payments thereafter, based upon a 25-year amortization.

The CMBS financings were collateralized by first mortgages on 86 and 14 of EHSI's skilled nursing centers, respectively, and all other assets owned by these centers including personal property and receivables.

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 2011, we defeased US$65.6 million of the March 2012 CMBS Financing followed by a defeasement of the remaining balance of US$21.0 million in December 2011. 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 17)*.

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 an 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 amount available to be borrowed under the US$80.0 million portion of the EHSI Credit Facility is 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.

The 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.

The amount available to be borrowed as of December 31, 2012, was US$100.0 million, of which EHSI had drawn US$8.1 million and issued US$2.6 million under a letter of credit, leaving US$89.3 million available for working capital and corporate purposes. The letter of credit of US$2.6 million is in favour of a state workers' compensation program, which renews annually and matures through to June 2013.

PRIVATEBANK LOANS

On November 30, 2010, EHSI secured a non-recourse term loan for up to US$35.0 million on six skilled nursing centers and one assisted living center located in Minnesota, Wisconsin and Michigan with the PrivateBank (the "PrivateBank Loans"). On closing, EHSI drew US$25.0 million of the term loan secured by five of the seven centers, and in March 2011 drew the remainder of the US$10.0 million available on the term loan and placed mortgages on the remaining centers. The loan is secured by mortgages on the seven centers. The PrivateBank Loans have a three-year term that matures on November 30, 2013. The loans are repaid with monthly principal payments based on a 25-year amortization period. Under the mortgage agreement, the combined operations are required to maintain a minimum consolidated fixed charge coverage ratio and debt service coverage ratio. At EHSI's option, the interest rate is equal to: (i) LIBOR, subject to a LIBOR floor set at 2%, plus a margin of 4%, or (ii) the U.S. prime rate subject to a floor of 6%. EHSI has the option to prepay the balance in whole or in part subject to a prepayment fee of 2% for the first two years of the agreement and 1% during the final year, with no prepayment fee during the last six months of the agreement.

NOTES PAYABLE

Notes payable primarily relate to seller notes with a balance of US$4.0 million at 7.5% as at December 31, 2012, arising from the 2007 acquisition of Tendercare (Michigan) Inc. (Tendercare) *(note 26)*. The remaining balance is payable in 2013.

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:

			2012			2011
	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	**808**	**124**	**684**	1,858	1,226	632
Between one and five years	**2,081**	**125**	**1,956**	6,297	4,564	1,733
More than five years	**–**	**–**	**–**	17,034	4,324	12,710
	2,889	**249**	**2,640**	25,189	10,114	15,075

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 rate method and recognized as part of net finance costs.

Extendicare completed public offerings of convertible unsecured subordinated debentures in June 2008 (the "2013 Debentures") and June 2007 (the "2014 Debentures"). The 2013 Debentures had a 7.25% coupon rate, an $11.35 conversion price and were due June 30, 2013; whereas the 2014 Debentures have a 5.7% coupon rate, a $19.90 conversion price and are due June 30, 2014. Both of the 2013 Debentures and the 2014 Debentures (collectively the "REIT Issued Convertible Debentures") were, prior to the 2012 Conversion, convertible into REIT Units at the option of the debentureholders. As the REIT Units were considered puttable instruments because they were redeemable at the option of the debentureholder, the REIT Issued Convertible Debentures, including the debt and equity components, were designated as financial liabilities valued at fair value, with changes in fair value recognized in net earnings as part of net finance costs. As a result of the 2012 Conversion, and subject to their conversion rights, the debentureholders are entitled to receive Common Shares on the same basis that REIT Units were previously issuable on the conversion thereof. However, unlike the REIT Units, since the Common Shares have no puttable attribute, the REIT Issued Convertible Debentures are required to be measured at fair value and be bifurcated as of the date of the 2012 Conversion. As of July 1, 2012, the REIT Issued Convertible Debentures were measured at fair value with no value ascribed to the equity component and the entire fair value was ascribed as a financial liability.

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 17)*.

With respect to the 2014 Debentures, the aggregate principal balance outstanding at December 31, 2012, was $113.9 million, and interest is payable semi-annually in June and December. 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 Canadian Mortgage and Housing Corporation (CMHC) program (the "CMHC Mortgages"). 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.

On December 30, 2011, Extendicare's Canadian operations refinanced mortgages on 20 centers insured by the CMHC totalling $72.4 million at a rate of 9.81% that were due to mature in March 2013, with new mortgages totalling the same amount. The new debt consisted of $36.2 million secured by nine centers at a rate of 2.986% maturing in 2022, $22.9 million secured by nine centers at a rate of 2.22% maturing in 2017, and a bridge loan of $13.3 million secured by two centers pending new fixed-rate mortgages negotiated in 2012. During the 2012 first quarter, $8.7 million of the bridge loan for one of the centers was converted from a variable-rate mortgage to a fixed-rate mortgage at 3.15%, due March 2022, using the existing CMHC certificate. In July 2012, the $4.6 million bridge loan on the second center was converted to a fixed-rate mortgage under a new CMHC certificate in the amount of $10.8 million at 2.93%, due December 2022.

In June 2009, ECI secured CMHC-insured financing of $19.6 million plus CMHC fees of $1.0 million, on its Lethbridge, Alberta, designated assisted living center. The loan has a 27-year term, and a requirement to maintain a minimum debt service coverage ratio. During construction, the loan was at a fixed rate of 4.25% that converted to a fixed-rate mortgage at 7.70% in January 2011. The final draw on the mortgage as a construction loan was received in February 2012, following which it was converted to a mortgage.

In August 2009, ECI secured CMHC-insured construction financing of $16.6 million for the Edmonton, Alberta, development project. The loan had a term of two years, with interest-only payments based on a floating rate of 30-day banker's acceptance plus 2.5%. In January 2012, ECI secured a 10-year CMHC-insured mortgage for $17.4 million on this center at a fixed interest rate of 3.81%, with payments amortized over 30 years.

NON-CMHC MORTGAGES

Non-CMHC mortgages are related to three Manitoba nursing centers that were assumed upon acquisition in 2008 and were subsequently refinanced in the same year. These are conventional mortgages at a fixed rate of 5.75% due in 2013.

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 interest rate of 7.08%.

Finance lease obligations are payable as follows:

			2012			2011
	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**	**7,472**	**4,632**	12,104	7,881	4,223
Between one and five years	**48,416**	**26,341**	**22,075**	48,416	28,193	20,223
More than five years	**116,508**	**32,872**	**83,636**	128,612	38,391	90,221
	177,028	**66,685**	**110,343**	189,132	74,465	114,667

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.

Other

RBC LINE OF CREDIT AND LETTERS OF CREDIT

Extendicare has a $70.0 million demand credit facility with the Royal Bank of Canada (the "RBC Credit Facility") for its Canadian operations. The RBC Credit Facility is secured by 14 Canadian nursing centers and guaranteed by certain Canadian operating subsidiaries of Extendicare. This credit facility is used to back letters of credit of which there were $43.1 million issued and outstanding as at December 31, 2012, leaving $26.9 million available. The $43.1 million of letters of credit secured $42.7 million of executive pension obligations, and $0.4 million related to construction projects.

In October 2011, Extendicare amended its RBC Credit Facility to reduce the maximum limit for the future transfer and assignment of the existing licensed beds at the current Timmins and Sault Ste. Marie centers upon completion of the new centers. As per an amendment signed subsequent to year end, this reduction will occur upon the assignment of the licensed beds of the Sault Ste. Marie and Timmins centers that is anticipated in March and June of 2013, in the amount of $3.0 million each.

In addition, Extendicare has a U.S. dollar letter of credit facility with the Royal Bank of Canada to provide for the issuance of a U.S. dollar letter of credit. As at December 31, 2012, a US$10.2 million letter of credit (December 31, 2011 – US$10.2 million) was issued to a third-party insurer of workers' compensation claims of EHSI and was secured by US$10.2 million in cash collateral held by RBC and invested in short-term deposits. As the cash is pledged as collateral against the letter of credit facility, its use is restricted and therefore, it is presented on the statements of financial position as restricted cash within current assets. In February 2013, the letter of credit was reduced from US$10.2 million to US$7.8 million, along with an equal decline in the required collateral.

RESTRICTED CASH

Restricted cash consists of the US$10.2 million in cash held by RBC as collateral for a letter of credit issued to a third-party insurer in respect of the workers' compensation claims described above and US$18.7 million held pursuant to the HUD regulatory agreements for working capital purposes.

UNDRAWN BORROWING FACILITIES

The Company has the following undrawn borrowing facilities:

	2012	2011
Variable Rate		
Expiring within one year	**26,864**	44,176
Expiring beyond one year	**88,845**	–
Total	**115,709**	44,176

FINANCING COSTS

Financing costs are deducted from long-term debt and are amortized using the effective interest rate method over the term of the debt. Financing costs included as part of long-term debt amounted to $30.8 million at December 31, 2012 (2011 – $22.1 million). The increase of $8.7 million in 2012 related primarily to the addition of $12.9 million of costs associated with financing of new and refinancing of existing debt, partially offset by amortization charges included in finance costs and changes in foreign exchange.

Below is a summary of the financing costs:

	Interest Rate	Year of Maturity		**2012**	2011
			US$	C$	C$
EHSI *(payable in US$)*					
HUD mortgages	3.20% – 5.75%	2022 – 2047	*16,611*	**16,528**	14,750
May 2012 CMBS Financing	6.6525%	2012	–	–	315
Line of credit	variable	2012	–	–	148
Line of credit	variable	2015	*2,541*	**2,528**	–
PrivateBank loans	variable	2013	*179*	**178**	378
			19,331	**19,234**	15,591
Extendicare Inc. and Canadian Subsidiaries *(payable in C$)*					
Convertible unsecured subordinated debentures	6.0%	2019		**5,284**	–
CMHC mortgages	2.22% – 7.7%	2013 – 2037		**5,161**	3,879
Non-CMHC mortgages	5.75%	2013		**54**	115
Finance lease obligations	6.41% – 7.19%	2026 – 2028		**429**	482
Construction loans	5.558% – 5.637%	2038		**677**	2,082
				11,605	6,558
Total financing costs				**30,839**	22,149
Less: current portion				**3,027**	1,707
				27,812	20,442

PRINCIPAL REPAYMENTS

Principal repayments on long-term debt, exclusive of finance lease obligations, are as follows:

Year	Amount
2013	90,878
2014	141,149
2015	29,278
2016	27,952
2017	39,004
2018 and beyond	724,020
	1,052,281

INTEREST RATES

The weighted average interest rate of all long-term debt at December 31, 2012, was approximately 5.0% (2011 – 5.5%). At December 31, 2012, 96.4% of the long-term debt, excluding financing costs, was at fixed rates.

12. Other Long-term Liabilities

	2012	2011
Accrued pension plan obligation *(note 23)*	**33,619**	33,020
Deferred compensation	**11,322**	11,635
Share appreciation rights	**217**	1,348
Future lease commitments	**1,680**	1,826
Other	**1,187**	1,809
	48,025	49,638

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. Share appreciation rights (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:

	2012		2011	
	Share Appreciation Rights	**Weighted Average Vesting Price**	Share Appreciation Rights	Weighted Average Vesting Price
Outstanding, beginning of year	**1,462,417**	**$9.49**	1,100,667	$8.48
Granted	**614,000**	**8.11**	682,000	10.99
Vested	**(389,667)**	**6.64**	–	–
Forfeited	**(70,000)**	**9.47**	(320,250)	(9.20)
Outstanding, end of year	**1,616,750**	**$9.66**	1,462,417	$9.49

The fair value of SARs was measured based on the Black-Scholes model. The inputs used in the fair value measurement for 2012 and 2011 were as follows:

	2012	2011
Share price	**$7.68**	$7.93
Volatility	**20.00%**	35.00%
Risk-free interest rate	**0.92% – 1.14%**	0.95% – 0.97%
Strike price	**$7.58 – $11.16**	$6.64 – $11.16
Expected remaining life	**0.2 years – 2.2 years**	2.2 years – 2.6 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, 2012, 1,616,750 SARs were outstanding, with an average remaining contractual life of 1.3 years (December 31, 2011 – 1.5 years). During 2012, $0.3 million was expensed in net earnings as an increase to the obligation in SARs (2011 – $0.3 million). The total liability was $0.2 million as at December 31, 2012 (December 31, 2011 – $1.3 million in other long-term liabilities).

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.

13. 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. 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.

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, 2011	–	$ –	*79,831,466*	$ 421,213
Transactions with unitholders:				
DRIP	–	–	*1,123,294*	9,245
Conversion from Exchangeable LP Units	–	–	*3,166,024*	22,684
Conversion from convertible debentures	–	–	*704*	8
Balance at December 31, 2011	–	$ –	*84,121,488*	$ 453,150
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**	**–**	**$ –**

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 2012, the Company issued 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 in connection with the DRIP (2011 – 1.1 million REIT Units at a value of $9.2 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 provides Extendicare with flexibility to repurchase Common Shares for cancellation until July 8, 2013, or on such earlier date as the Bid is complete. In July 2012, Extendicare acquired for cancellation 13,600 Common Shares at a cost of $0.1 million.

There were no purchases for cancellation made under a similar normal course issuer bid that expired on January 10, 2012.

14. 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, 2011	1,073	(644)	429	(19,007)	(18,578)
Recognized during the year	59	(115)	(56)	5,373	5,317
Balance, December 31, 2011	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)**

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.

15. Revenue

EHSI derived approximately 79% of its revenue from services provided under the federal (Medicare) and state (Medicaid) programs in 2012 and 80% in 2011. 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 66% of ECI's nursing home revenue, and approximately 97% of ECI's home health care revenue for both 2012 and 2011.

16. Expenses by Nature

	2012	2011
Employee wages and benefits	**1,363,719**	1,370,347
Food, drugs, supplies and other variable costs	**180,984**	185,627
Property based and other costs	**298,471**	326,973
Total operating expenses and administrative costs	**1,843,174**	1,882,947
Lease costs	**10,986**	10,999
Total expenses	**1,854,160**	1,893,946

17. Loss from Asset Impairment, Disposals and Other Items

	2012	2011
Asset impairment	**2,806**	54,012
Debt settlement	**545**	11,015
Loss on Kentucky lease transaction	**3,649**	–
2012 Conversion costs	**930**	–
Release of provision for contingent liabilities	–	(2,397)
Gain on disposals	–	(494)
Other	–	360
Loss from asset impairment, disposals and other items	**7,930**	62,496

2012

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 2012 third quarter. Goodwill and corporate assets are allocated to EHSI's CGUs. The carrying value of the assets was then compared to the recoverable amount for each CGU to determine if there was any impairment. The recoverable amount of a CGU is determined to be the greater of fair value less cost to sell and value-in-use calculations. Any impairment loss was 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 *(note 3(i))*.

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 in 2012 to determine recoverable amount were as follows:

Capitalization rates:	
Nursing centers	12.6%
Assisted living centers	8.6%
Maintenance capital expenditure per bed	US$300
Management fee as a % of revenue	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 the third quarter of 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 7)*.

Based upon the impairment assessment we performed for the U.S. in the 2012 third quarter, a 10-basis point increase in capitalization rate would cause a $0.1 million increase in goodwill impairment. As for the Canadian operations, based upon the impairment assessment we performed at the end of the year, there would be no impairment if we increased our capitalization rate by 10 basis points.

In September 2012, ECI recorded an impairment loss of $2.6 million to reduce to fair value an Ontario nursing center, which is to be closed upon completion of a new center. In addition, a debt settlement charge of $0.1 million related to the prepayment penalty on the mortgage for this center was recorded, which will be incurred when the center is closed.

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 11)*.

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 *(note 11)*.

In the second quarter of 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 6)*. As a result of this transaction, a pre-tax loss of $3.6 million (US$3.6 million) was recorded in 2012.

Extendicare incurred $0.9 million relating to the 2012 Conversion *(notes 1 and 13)*.

2011

As a result of the CMS announcement in July 2011 to reduce Medicare rates along with other changes, EHSI recognized a pre-tax impairment loss of $54.0 million (US$53.9 million) in the 2011 third quarter, of which $22.4 million (US$22.3 million) related to goodwill *(note 7)*, and $31.7 million (US$31.6 million) to property and equipment *(note 6)*.

In December 2011, the Canadian operations refinanced $72.4 million in mortgages secured by 20 CMHC-insured centers that were at fixed rates of 9.81% and due to mature in March 2013 *(note 11)*. As a result, a prepayment penalty of approximately $7.5 million was recognized in the 2011 fourth quarter.

During the third and fourth quarters of 2011, EHSI prepaid US$367.3 million of the May 2012 CMBS debt and defeased US$86.6 million of the March 2012 CMBS debt, respectively. EHSI recorded a pre-tax loss of $2.5 million (US$2.5 million) on retirement of debt that included a defeasance penalty of $1.4 million (US$1.4 million), transaction fees of $0.3 million (US$0.3 million), and the write-off of unamortized loan fees on the debt of $0.8 million (US$0.8 million) *(note 11)*.

In October 2011, the new 180-bed long-term care center in Edmonton, Alberta, was completed. The existing nursing center in Edmonton (113 operational beds) was closed in November and a charge of $0.4 million related to a mortgage prepayment penalty was incurred.

In June 2011, ECI completed the sale of the Lethbridge, Alberta, property (120-bed closed nursing center) for net proceeds of $1.0 million that resulted in a pre-tax gain of $0.2 million in the 2011 second quarter. During the 2011 first quarter when the center closed, a charge of $0.6 million was incurred related to a mortgage prepayment penalty.

In May 2011, EHSI completed the sale of the Saginaw, Michigan, skilled nursing center for net proceeds of $3.8 million (US$3.9 million) that resulted in a pre-tax gain of $0.3 million (US$0.3 million).

Previously, Extendicare had a provision for contingent liabilities in connection with the sale of its investment in Crown Life. In April 2011, settlement was reached on one of the claims below the amount accrued for that particular item, resulting in the release of $0.5 million of the provision. Another settlement was reached in August 2011 for the remaining claim, resulting in the release of the remainder of the provision of $1.9 million *(note 10)*.

18. Finance Costs and Finance Income

Convertible Debentures

The fair value adjustment on REIT Issued Convertible Debentures was a gain of $4.8 million for 2012, compared to a loss of $0.6 million for 2011. This related to the remeasurement of the liability at fair value at the end of each period.

Exchangeable LP Units

The Exchangeable LP Units were intended to be economically equivalent to the REIT Units, to the greatest extent practicable. Distributions on Exchangeable LP Units of $2.2 million were recognized for 2011 in net earnings as part of finance costs. These Exchangeable LP Units were designated as financial liabilities valued at FVTPL with changes in fair value recognized in net earnings as part of finance costs. The fair value adjustment on Exchangeable LP Units resulted in a gain of $6.6 million for 2011. They were exchangeable on a one-for-one basis for REIT Units at the option of the holder, and all remaining Exchangeable LP Units were automatically exchanged for REIT Units on November 10, 2011.

Transactions between Canadian and U.S. Subsidiaries

We recorded foreign exchange losses of $1.1 million for 2012 and gains of $0.2 million for 2011. These related primarily to the payment of dividends in 2012 from U.S. subsidiaries to Canadian subsidiaries and in 2011 to the change in value of foreign currency-denominated notes between EHSI and some of the Canadian-based subsidiaries.

Foreign Currency Derivatives

We recorded a gain of $0.4 million in 2011 related to the revaluation of EHSI's contracts that locked in the purchase of Canadian dollars at specified foreign exchange rates. There were no such contracts during 2012.

19. 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 (EPU) 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.

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

20. 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 7)*.

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

	2012	2011
Results from discontinued operations		
Other revenue	–	12,286
Operating expenses	–	4,194
Lease costs	–	48
Total expenses	–	4,242
Earnings before depreciation and amortization	–	8,044
Depreciation and amortization	–	81
Gain on asset disposals	**(56,453)**	–
Earnings before income taxes	**56,453**	7,963
Income tax expense	**21,420**	3,036
Earnings from discontinued operations	**35,033**	4,927
Cash flows from discontinued operations		
Net cash from operating activities	**693**	4,697
Net cash from investing activities	**56,323**	(53)
Net cash from financing activities	–	–
Effect on cash flows	**57,016**	4,644

21. Income Taxes

Extendicare is the successor to Extendicare REIT following the 2012 Conversion. 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 (Loss)

	2012	2011
Current tax expense		
Current year	**31,924**	31,332
Accelerated tax depreciation	**(4,124)**	(2,483)
Other prior year adjustments	**(1,071)**	2,467
	26,729	31,316
Deferred tax expense (recovery)		
Origination and reversal of temporary difference	**4,111**	(16,605)
Accelerated tax depreciation	**3,612**	2,692
Change in statutory tax rate	**805**	–
Change in recognized deductible temporary differences	**(3,265)**	(925)
	5,263	(14,838)
Total tax expense	**31,992**	16,478
Tax expense from continuing operations	**10,572**	13,442
Tax expense from discontinued operations	**21,420**	3,036
Total tax expense	**31,992**	16,478

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, upon completion of the 2009, 2010 and 2011 returns in 2010, 2011 and 2012, respectively, further recoveries of $4.4 million (US$4.3 million) were recorded in 2010, $2.5 million (US$2.5 million) in 2011 and $4.1 million (US$4.1 million) in 2012. 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)

	2012			2011		
	Before Tax	**Tax Recovery**	**Net of Tax**	Before Tax	Tax Recovery	Net of Tax
Foreign currency translation differences for foreign operations	**(4,867)**	–	**(4,867)**	5,373	–	5,373
Available-for-sale financial assets	**1,190**	–	**1,190**	(56)	–	(56)
Deferred benefit plan actuarial losses	**(1,400)**	**415**	**(985)**	(4,402)	1,122	(3,280)
	(5,077)	**415**	**(4,662)**	915	1,122	2,037

Effective Tax Rate

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

	2012	2011
Earnings (loss) from continuing operations before income taxes	**38,195**	(21,881)
Income taxes at statutory rates of 26.5% (2011 – 28.25%)	**10,121**	(6,181)
Income tax effect relating to the following items:		
Tax rate variance of foreign subsidiaries	**2,156**	11,294
Foreign exchange loss (gain)	**292**	(121)
Reversal of previously recognized items	**(3,640)**	1,709
Non-deductible items	**2,088**	9,857
Non-taxable income	**(1,585)**	(2,442)
Other items	**1,140**	(674)
	10,572	13,442

Summary of Operating and Capital Loss Carryforwards

At December 31, 2012, Extendicare's U.S. corporate subsidiaries had net operating loss carryforwards available for U.S. state income tax purposes of $31.0 million (US$31.2 million), which expire in the years 2013 through 2032, and had $10.1 million (US$10.2 million) of net operating loss carryforwards available for U.S. federal income tax purposes, which expire in the years 2021 through 2032. In addition, Extendicare's Canadian corporate subsidiaries had $32.6 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, 2012, there were capital losses of $21.5 million (2011 – $21.7 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 $2.9 million (2011 – $2.9 million).

Net deferred tax liabilities increased in 2012 by $0.9 million to $180.5 million from $179.6 million at December 31, 2011. 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:

	2012	2011
Deferred tax assets	**21,917**	35,752
Deferred tax liabilities	**202,417**	215,326
Deferred tax liabilities, net	**180,500**	179,574

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, 2011	Recognized in Net Loss	Recognized in Other Comprehensive Income	Other	Recognized in Other Comprehensive Income re: FX	Balance December 31, 2011
Deferred tax liabilities						
Property and equipment	245,461	(15,660)	–	–	4,497	234,298
Leasehold rights	395	(139)	–	–	9	265
Other	13,876	2,614	–	1,123	803	18,416
	259,732	(13,185)	–	1,123	5,309	252,979
Deferred tax assets						
Self-insurance reserves	9,758	3,241	–	–	305	13,304
Employee benefit accruals	20,841	(1,580)	1,122	–	281	20,664
Operating loss carryforwards	8,237	2,628	–	–	32	10,897
Deferred revenue	6,159	(1,716)	–	–	–	4,443
Accounts receivable reserves	4,732	(2,334)	–	–	41	2,439
Decommissioning provision	7,733	665	–	–	152	8,550
Other	12,113	749	–	–	246	13,108
	69,573	1,653	1,122	–	1,057	73,405
Deferred tax liabilities, net	190,159	(14,838)	(1,122)	1,123	4,252	179,574

	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**

22. Commitments and Contingencies

Operating Lease Commitments

At December 31, 2012, the Company was committed under non-cancellable leases requiring future minimum rentals as follows:

	Operating Leases
2013	7,286
2014	6,755
2015	5,755
2016	5,278
2017	4,829
2018 and beyond	10,348
Total minimum payments	40,251

Property and Equipment Commitments

As at December 31, 2012, outstanding capital expenditure commitments for EHSI totalled $8.2 million (US$8.3 million); and those for ECI totalled $24.7 million, relating to two redevelopment projects.

Construction for the two Ontario redevelopment projects totalling 436 beds, at a cost of approximately $80 million, is anticipated to be completed by the end of June 2013. The new 180-bed nursing center in Timmins and a new 256-bed nursing center in Sault Ste. Marie will replace two owned centers (287 class "C" beds) and one leased center (95 interim beds) in the area.

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 11)*.

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 26)*. 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 spin-off of Assisted Living Concepts, Inc. (ALC) in 2006 to Extendicare's shareholders, Extendicare, EHSI and ALC entered into a number of transactions and agreements including a separation agreement (the "Separation Agreement"), a number of transitional service agreements, and a number of operating leases and purchase 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 by ALC. LTC declined to remove EHSI as a party to the leases following the distribution of ALC by Extendicare to its shareholders in November 2006. Therefore, EHSI continues to be bound by the terms of the leases, while only ALC has a financial interest in the leased properties. The Separation Agreement provides EHSI with indemnification against any claims arising as a result of ALC's non-performance relating to the LTC Master Leases. EHSI, being a party to the LTC Master Leases, has to approve any renewal options being exercised.

The LTC Master Leases provide for an initial 10-year term and three successive 10-year lease terms at the option of the lessee. There are no significant economic penalties if the renewal options are not exercised. The aggregate minimum rental payments for the 2013 year are approximately US$11.8 million and will increase by 2% for the remaining calendar year of 2014. Annual minimum rent during any renewal term will increase by a minimum of 2% over the minimum rent of the immediately preceding year.

In its 2012 third quarter 10-Q filing with the U.S. Securities and Exchange Commission (the "SEC"), ALC stated that it may not meet its financial covenants with its line of credit. On January 7, 2013, ALC filed a Form 8-K with the SEC stating that on December 31, 2012, it had entered into a waiver and amendment agreement with its lenders that, among other things: (i) waived existing alleged defaults under its line of credit; (ii) waived any non-compliance of the financial covenants that may occur on or before December 31, 2012, and for the period ending March 31, 2013; (iii) requires ALC to provide its lenders, on or before March 31, 2013, a fully executed agreement that provides for the repayment of all obligations under the line of credit within a reasonable amount of time, with such transaction to close by August 15, 2013; and (iv) requires ALC to obtain no less than US$15.0 million from a new credit facility, sale of unencumbered assets, or otherwise, on or before July 2, 2013.

On February 25, 2013, ALC announced that it has entered into a definitive agreement with affiliates of TPG Capital, L.P. (collectively "TPG"), a global private investment firm, whereby TPG has agreed to acquire all of the outstanding Class A and B shares of ALC for cash. The closing of the transaction is conditional upon, among other things, affirmative votes of ALC's shareholders, the receipt of customary regulatory approvals and other customary closing conditions. However, the transaction is not subject to a financing condition. At this time, and based upon information provided in ALC's 8-K filing dated February 26, 2013, 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. No details were provided in the announcement with respect to ALC's line of credit.

Based upon a legal and financial assessment of risk associated with the LTC Master Lease, EHSI believes that its maximum exposure, which is dependent on a number of factors, is less than US$4.0 million for the remaining term of the lease. However, management believes that this potential liability is not probable; consequently, no provision has been recognized as at December 31, 2012.

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 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 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 and, where appropriate, accrues for costs that may result from such investigations to the extent such costs are probable and estimable.

As previously disclosed, EHSI has received subpoenas from the U.S. Department of Health and Human Services (DHHS), Office of the Inspector General (OIG), relating to the possible submission of claims that they believe may be in violation of the U.S. Social Security Act. In November 2012 and March 2013, representatives of the OIG and the U.S. Department of Justice (DOJ) met with senior representatives of EHSI to discuss their investigation to date related to quality of care. EHSI continues to cooperate with them in their investigation, which also includes the provision and billing of rehabilitation services.

If Extendicare is found to have violated the U.S. Social Security Act or other applicable laws and regulations, Extendicare may incur, among other things, fines, civil monetary penalties, recoupments and administrative sanctions (including suspension or exclusion from participation in the Medicare and Medicaid programs). Any of these outcomes could have a material adverse effect on the business, results of operations, or financial condition of Extendicare. At the present time, Extendicare is unable to predict the ultimate outcome of the DHHS OIG subpoenas referred to above, including any required corrective action, or to estimate the costs that may result. Extendicare believes that it is in material compliance with the U.S. Social Security Act and other applicable laws and regulations. Based on current knowledge, management does not believe that liabilities, if any, arising from these matters will have a material adverse effect on the consolidated financial position, or results of operations of Extendicare.

23. Employee Benefits

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

Defined Benefit Plans

Extendicare provides a registered defined benefit pension plan, as well as a supplementary plan that is an unfunded defined benefit pension arrangement for certain of its executives, both of which have been closed to new entrants for several years. The registered defined benefit plan was fully funded with plan assets of $5.7 million and accrued benefit obligations of $7.6 million as at December 31, 2012. The accrued benefit obligations of the supplementary plan were $33.8 million as at December 31, 2012. We do not set aside assets in connection with the supplementary plan and the benefit payments made thereunder are funded from our cash from operations. We measure our accrued benefit obligations and the fair value of plan assets for accounting purposes at December 31st of each year. A discount rate of 4.0% was used to determine the benefit expense in 2012, and a discount rate of 3.75% was used to calculate the accrued benefit obligation at the end of 2012. Actuarial valuation reports of the defined benefit pension plans are completed every three years. The most recent actuarial review was performed effective October 1, 2012, and will be completed in early 2013. Additional information for these benefit plans is provided in the following tables.

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

	Funded Defined Benefit Plan		Unfunded Supplementary Defined Benefit Plan		Total	
	2012	2011	**2012**	2011	**2012**	2011
Fair value of plan assets	**5,683**	5,644	**–**	–	**5,683**	5,644
Present value of obligations	**7,648**	7,587	**33,840**	33,253	**41,488**	40,840
Deficit	**(1,965)**	(1,943)	**(33,840)**	(33,253)	**(35,805)**	(35,196)

	2012	2011	2010
Experience gains (losses) arising on plan assets	**121**	(582)	152
Experience losses arising on plan liabilities	**(405)**	(21)	(420)

Additional information for these benefit plans is provided in the following tables:

	2012	2011
Present value of defined benefit obligations		
Accrued benefit obligations		
Balance at beginning of year	**40,840**	37,652
Current service cost	**162**	149
Benefits paid	**(2,621)**	(2,606)
Interest costs	**1,587**	1,825
Actuarial losses	**1,520**	3,820
Balance at end of year	**41,488**	40,840
Plan assets		
Fair value at beginning of year	**5,644**	6,259
Employer contributions	**2,186**	2,180
Expected return on assets	**353**	393
Actual return on plan assets	**121**	(582)
Benefits paid	**(2,621)**	(2,606)
Fair value at end of year	**5,683**	5,644
Defined benefit obligations	**35,805**	35,196

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

	2012	2011
Reported in Extendicare's statement of financial position		
Current accrued liabilities	**2,186**	2,176
Other long-term liabilities *(note 12)*	**33,619**	33,020
Accrued benefit liability at end of year	**35,805**	35,196

	2012	2011
Percentage of plan assets		
Equities	**64%**	60%
Fixed income securities	**33%**	34%
Cash and short-term investments	**3%**	6%
	100%	100%

	2012	2011
Expense recognized in net earnings (loss)		
Annual benefit plan expense		
Current service costs	**162**	149
Interest cost	**1,587**	1,825
Expected return on plan assets	**(353)**	(393)
Plan benefit expense recognized in the year – included in operating expenses and administrative costs	**1,396**	1,581

	2012	2011
Actuarial gains or losses recognized in other comprehensive income (loss)		
Amount accumulated in accumulated deficit, January 1	**(5,477)**	(2,197)
Recognized during the year	**(985)**	(3,280)
Amount recognized in accumulated deficit at December 31	**(6,462)**	(5,477)

	2012	2011
Significant actuarial assumptions		
Discount rate for year-end accrued obligation	**3.75%**	4.00%
Discount rate for period expense	**4.00%**	5.00%
Expected long-term rate of return on plan assets	**6.5%**	6.5%
Rate of compensation increase	**2.0%**	2.0%
Income Tax Act increase rate	**3.0%**	5.0%
Average remaining service years of active employees	**5**	6

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.

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 2012 and 2011 were $11.9 million and $11.5 million, respectively. EHSI pays a discretionary matching contribution. Contributions expensed by EHSI in 2012 and 2011 were US$1.5 million and US$2.7 million, respectively.

24. 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, 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	**35,508**	**35,508**	35,508	–	–	–
	1,198,582	**1,862,152**	189,285	196,188	242,974	1,233,705

As at December 31, 2011	Carrying Amount	Contractual Cash Flows	Less than 1 Year	1–2 Years	2–5 Years	More than 5 Years
Convertible debentures	214,309	231,951	13,150	101,624	117,177	–
CMBS Financings	111,755	119,189	119,189	–	–	–
Line of Credit	53,901	57,369	57,369	–	–	–
HUD mortgages	402,060	760,665	25,336	25,369	75,945	634,015
PrivateBank loans	35,076	39,253	2,661	36,592	–	–
CMHC mortgages	166,308	197,593	16,760	43,094	51,601	86,138
Non-CMHC mortgages	15,912	17,571	1,293	16,278	–	–
Finance lease obligations	129,742	214,321	13,962	13,963	40,750	145,646
Construction loans	18,288	44,301	1,631	1,675	5,083	35,912
Notes payable	9,238	10,219	5,776	4,408	35	–
Accounts payable	42,241	42,241	42,241	–	–	–
	1,198,830	1,734,673	299,368	243,003	290,591	901,711

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	
	2012	2011
Cash and short-term investments	**71,398**	80,018
Restricted cash *(note 11)*	**28,680**	16,848
Total receivables, net of allowance(1) *(note 5)*	**220,913**	245,784
Investments held for self-insured liabilities *(note 8)*	**115,025**	83,608
Notes, mortgages and amounts receivable *(note 8)*	**50,037**	48,010
	486,053	474,268

(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 for collateral and regulatory requirements with no credit risk *(note 11)*.

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.

	2012			2011		
	Carrying Amount			Carrying Amount		
	U.S. Dollar	**Canadian Dollar**	**Total**	U.S. Dollar	Canadian Dollar	Total
Trade receivables	**146,667**	**18,905**	**165,572**	168,744	18,194	186,938
Retroactive rate receivables	**23,652**	**2,251**	**25,903**	33,475	1,899	35,374
Other receivables	**17,412**	**12,026**	**29,438**	15,821	7,651	23,472
	187,731	**33,182**	**220,913**	218,040	27,744	245,784

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, 2012, receivables from government agencies represented approximately 70% 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 of December 31, 2012, the U.S. operations (mainly EHSI) had trade receivables of $146.7 million (2011 – $168.7 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 involving claims against private residents that were denied HMO or Medicaid benefits. In 2012, EHSI incurred a provision for receivable impairment of $18.4 million (2011 – $15.6 million).

As of December 31, 2012, retroactive rate receivables of $23.7 million (2011 – $33.5 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 of December 31, 2012, ECI had trade receivables of $18.9 million (2011 – $18.2 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. In 2012, ECI incurred a provision for receivable impairment of $0.6 million (2011 – $0.7 million).

The aging analysis of these trade receivables is as follows:

	2012	2011
Current	**101,330**	110,554
Between 30 and 90 days	**48,900**	59,441
Between 90 and 365 days	**25,741**	26,828
Over 365 days	**8,053**	6,790
Less: provision for receivable impairment	**(18,452)**	(16,675)
Total	**165,572**	186,938

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

	2012	2011
At January 1	**16,675**	17,796
Increase in provision for receivable impairment	**18,951**	16,292
Receivables written off as uncollectible	**(16,827)**	(17,745)
Other	**(347)**	332
At December 31	**18,452**	16,675

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 $34.3 million (2011 – $37.2 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 period. 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, 2012 and 2011, was as follows:

(in thousands of US$)	**2012**	2011
Assets		
Current assets	**254,320**	273,284
Property and equipment, goodwill and other intangibles, and other assets	**1,051,882**	1,053,764
Liabilities		
Current liabilities	**225,651**	373,803
Long-term debt and other liabilities	**805,502**	706,502
Net asset exposure	**275,049**	246,743

Net Earnings Sensitivity Analysis

The majority of the Company's operations are conducted in the United States, which accounted for approximately 64% of its total revenue in 2012.

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 and fair value of the FCFCs, remain constant.

Favourable (unfavourable) impact	**2012**	2011
Net earnings	**–**	(2)
Other comprehensive income	**(2,750)**	(2,467)

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, 2012, 96.4% of our outstanding long-term debt was at fixed rates and $41.8 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, 2012 and 2011 was as follows:

	Carrying Amount	
	2012	2011
Fixed-rate instruments:		
Investments held for self-insured liabilities[(1)]	**97,108**	62,262
Less: long-term debt[(2)]	**1,121,241**	1,054,291
Net liability in fixed-rate instruments	**1,024,133**	992,029
Variable-rate instruments:		
Long-term debt[(2)]	**41,833**	102,298
Total liability in variable-rate instruments	**41,833**	102,298

(1) Excludes variable-rate instruments.
(2) Includes current portion and excludes 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, 2012, 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 rate 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.

	2012		2011	
Favourable (unfavourable) impact	**100bp Increase**	**100bp Decrease**	100bp Increase	100bp Decrease
Net earnings	**(353)**	**353**	(193)	193

(b) Fair Values of Financial Instruments

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**
Invested assets[(1)]	**458**				**458**	**458**
Trade and other receivables[(2)]	**217,989**	–	–	–	**217,989**	**217,480**
Notes, mortgages and amounts receivable	**52,961**	–	–	–	**52,961**	**59,079**
Investments held for self-insured liabilities	–	**115,025**			**115,025**	**115,025**
	342,806	**115,025**	–	–	**457,831**	**463,440**
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.

As at December 31, 2011	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	80,018	–	–	–	80,018	80,018
Invested assets(1)	650	–	–	–	650	650
Trade and other receivables(2)	243,029	–	–	–	243,029	241,889
Notes, mortgages and amounts receivable	50,765	–	–	–	50,765	57,090
Investments held for self-insured liabilities	–	83,608	–	–	83,608	83,608
	374,462	83,608	–	–	458,070	463,255
Financial liabilities:						
Accounts payable	–	–	–	42,241	42,241	42,241
Long-term debt excluding convertible debentures(2)(3)	–	–	–	942,280	942,280	985,451
Convertible debentures	–	–	214,309	–	214,309	214,309
	–	–	214,309	984,521	1,198,830	1,242,001

(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 held to maturity and 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 value of the FCFCs is based upon the valuation as provided by the financial institution that is the counterparty to the agreements.

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, 2012	**Level 1**	**Level 2**	**Level 3**	**Total**
Available-for-sale securities	**115,025**	–	–	**115,025**
Total assets	**115,025**	–	–	**115,025**
Financial liabilities designated at fair value through profit or loss	–	**117,325**	–	**117,325**
Total liabilities	–	**117,325**	–	**117,325**

As at December 31, 2011	Level 1	Level 2	Level 3	Total
Available-for-sale securities	83,608	–	–	83,608
Total assets	83,608	–	–	83,608
Financial liabilities designated at fair value through profit or loss	–	214,309	–	214,309
Total liabilities	–	214,309	–	214,309

25. 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 74% of our consolidated operating costs for 2012 (2011 – 73%). 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 has taken action to reduce operational and corporate office staff and realize savings in supplies, drugs, and third-party service arrangements with vendors. None of these cost saving measures involved a reduction of direct care staffing at our centers.

DECLINE IN SHORT-TERM ADMISSIONS IN THE U.S.

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 the decline we have experienced in Medicare and total admissions was in part due to individuals deferring hospital elective surgery 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 rates has been the concerted effort by state Medicaid programs to shift potential residents to home care programs and assisted living centers, along with Managed Care programs, constraining the period of coverage in skilled nursing centers 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, we are also 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 are the establishment of Active Life Transition Units (ALTUs), which are upgraded suites within our centers targeted to attract short-term rehabilitation residents. Since launching the program in 2009, we have completed 14 ALTUs and plan to continue to expand the number of ALTUs within certain of our centers.

Normal Course Issuer Bid

On July 5, 2012, Extendicare received approval of the TSX for the Bid *(note 13)*. 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.

	2012	2011
Current portion of long-term debt[(1)]	**93,448**	192,698
Long-term debt[(1)]	**1,038,787**	941,742
Total debt	**1,132,235**	1,134,440
Less: cash and short-term investments	**(71,398)**	(80,018)
Net debt	**1,060,837**	1,054,422
Share/unit capital	**467,463**	453,150
	1,528,300	1,507,572

(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 CMBS financings, PrivateBank Loans and 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 its construction loans on the level of debt to cash flow of its operations *(note 11)*. 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 of December 31, 2012.

26. Related Party Transactions

(a) Transactions with Key Management Personnel

In 2008, Tim Lukenda, the former President of Tendercare, was appointed President and Chief Executive Officer of Extendicare. Prior to its acquisition by EHSI, Mr. Lukenda owned an approximate 4.6% direct and indirect interest in Tendercare and received, directly or indirectly, on completion of the acquisition of Tendercare, an equivalent percentage of the consideration paid by EHSI. In October 2007, EHSI completed a $225.0 million acquisition (US$238.2 million) of Tendercare, which comprised 29 skilled nursing centers and one inpatient rehabilitation hospital in Michigan, for a total of 3,301 operational beds. As part of Mr. Lukenda's terms of employment, the employment contract provides a mechanism and process that effectively removes Mr. Lukenda from the decision-making process in situations where a conflict of interest may arise on any matter between Extendicare and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extendicare and its subsidiaries. As part of the acquisition of Tendercare, in addition to normal representative and warranty provisions, EHSI must agree on any adjustments to the final purchase price as described above, before making any payments to Mr. Lukenda or his family. EHSI and ECI also provide certain management services to two long-term care centers and operate, under lease arrangements, two other long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

In connection with the purchase of Tendercare, the acquired working capital is subject to annual adjustments that will occur 90 days after the anniversary date of the Tendercare acquisition over a four-year period until January 2012. Working capital adjustments made to date have resulted in an increase of working capital with no impact to the consolidated net earnings and payments of US$5.5 million by EHSI. The fourth and final adjustment was paid in the third quarter of 2012.

In addition, in connection with the acquisition of LTC Professional in 2008, Tendercare's affiliated insurance company, consideration for the acquisition is to be adjusted annually based upon the actuarial liabilities determined at December 31st of each year through to 2012, with an annual option to extend to 2015. In March of 2012, 2011, 2010 and 2009, ECI made annual settlements of US$0.1 million, US$1.3 million, US$1.5 million and US$2.2 million, respectively.

(b) Compensation of Key Management Personnel

The remuneration of directors and other key management personnel of the company during the years ended December 31, 2012 and 2011, was as follows:

	2012	2011
Short-term benefits	**4,257**	4,266
Post-employment benefits	**213**	203
Share appreciation rights	**(77)**	222
	4,393	4,691

27. 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				
2012	1,299,540	508,571	(195)	1,807,916
2011	1,349,608	481,272	(176)	1,830,704
Total Liabilities				
2012	1,027,261	726,190	(195)	1,753,256
2011	1,098,640	683,921	(176)	1,782,385
Total Capital Expenditures				
2012	31,930	53,046	–	84,976
2011	31,973	32,530	–	64,503

	United States	Canada	Eliminations	2012 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
Results from operating activities	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
Losses 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

				2011
	United States	Canada	Eliminations	Total
CONTINUING OPERATIONS				
Revenue				
Nursing and assisted living centers	1,355,289	525,831	–	1,881,120
Home health care	–	165,030	–	165,030
Health technology services	19,120	–	–	19,120
Outpatient therapy	13,750	–	–	13,750
Rent, management, consulting and other services	7,571	7,491	–	15,062
Total revenue	1,395,730	698,352	–	2,094,082
Operating expenses	1,206,881	606,911	–	1,813,792
Administrative costs	47,941	21,214	–	69,155
Lease costs	6,546	4,453	–	10,999
Total expenses	1,261,368	632,578	–	1,893,946
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items	134,362	65,774	–	200,136
Depreciation and amortization	58,242	18,335	–	76,577
Loss from asset impairment, disposals and other items	56,195	6,301	–	62,496
Results from operating activities	19,925	41,138	–	61,063
Interest expense	52,539	37,226	(131)	89,634
Accretion of decommissioning provisions	1,234	372	–	1,606
Other accretion	423	–	–	423
Distributions on Exchangeable LP Units	–	2,179	–	2,179
Finance costs	54,196	39,777	(131)	93,842
Interest revenue	388	4,065	(131)	4,322
Fair value adjustments	–	6,023	–	6,023
Gains on foreign exchange and financial instruments	250	303	–	553
Finance income	638	10,391	(131)	10,898
Net finance costs	53,558	29,386	–	82,944
Earnings (loss) before income taxes	(33,633)	11,752	–	(21,881)
Income tax expense (recovery)				
Current	23,280	5,000	–	28,280
Deferred	(12,499)	(2,339)	–	(14,838)
Total income tax expense	10,781	2,661	–	13,442
Earnings (loss) from continuing operations	(44,414)	9,091	–	(35,323)
DISCONTINUED OPERATIONS				
Earnings from discontinued operations, net of income taxes	4,927	–	–	4,927
Net earnings (loss)	(39,487)	9,091	–	(30,396)

28. Significant Subsidiaries

The following is a list of the significant subsidiaries as of December 31, 2012, 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
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

Mel Rhinelander [B]
Chairman

Timothy L. Lukenda
President and Chief Executive Officer

John F. Angus [A]
Senior Partner of PerformaCorp Inc.

Margery Cunningham [A, B]
Vice President, Avalere Health LLC

Governor Howard B. Dean [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

Benjamin J. Hutzel [A]
Retired Partner, Bennett Jones LLP

Michael J. L. Kirby [HR/GN, QC]
Chair of Partners for Mental Health, a professional director and a retired member of the Senate of Canada

Alvin G. Libin [HR/GN, B]
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

Frederick B. Ladly
Retired Chairman and Chief Executive Officer of Extendicare

George A. Fierheller
President of Four Halls Inc.

A	Audit Committee
B	Buyback Committee
HR/GN	Human Resources, Governance and Nominating Committee
QC	Quality and Compliance Committee

Officers and Executives

Extendicare Inc.

3000 Steeles Avenue East, Suite 700
Markham, Ontario, Canada
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Fax: (905) 470-5588

Mel Rhinelander
Chairman

Timothy L. Lukenda
President and Chief Executive Officer

Douglas J. Harris
Senior Vice President and
Chief Financial Officer

Jillian E. Fountain
Corporate Secretary

Extendicare Health Services, Inc.

111 West Michigan Street
Milwaukee, Wisconsin, U.S.A.
53203-2903
Tel: (414) 908-8000
Tel: (800) 395-5000
Fax: (414) 908-8059

Timothy L. Lukenda
Chairman and Chief Executive Officer

Richard Gurka
Senior Vice President, Operations

Douglas J. Harris
Senior Vice President,
Chief Financial Officer and Treasurer

Jillian E. Fountain
Corporate Secretary

Stephen Biondi
Vice President, External Affairs

William Bryan
Vice President, Design & Development

Loren W. Claypool
Vice President and Chief Information Officer

Timothy Detary
Vice President, Human Resources

David Keating
Vice President and Deputy General Counsel

Donna Maassen
Vice President and Chief Compliance Officer

LaRae L. Nelson
Vice President, Reimbursement

David C. Pearce
Vice President and General Counsel

Judith Taubenheim
Vice President, Clinical Services

Extendicare (Canada) Inc.

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Timothy L. Lukenda
Chairman and Chief Executive Officer

Paul Tuttle
President

Douglas J. Harris
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

Richard Luneburg
Vice President, Western Operations

Christina L. McKey
Vice President, Eastern Operations

Katharine O'Reilly
Vice President, Quality and
Performance Improvement

Sue Pearl-Agar
Vice President, ParaMed Home Health Care

Five-year Summary[1]

(unaudited) (thousands of dollars unless otherwise noted)	**2012**	2011	2010	2009	2008
Financial Position					
Property and equipment	**1,181,596**	1,192,913	1,206,656	863,430	970,612
Total assets	**1,807,916**	1,830,704	1,994,634	1,668,065	1,806,922
Long-term debt, including current portion	**1,132,235**	1,134,440	1,241,196	1,234,032	1,332,813
Shareholders'/unitholders' equity (deficiency)	**54,660**	48,319	112,994	(40,903)	(29,532)
Financial Results					
Revenue					
Nursing and assisted living centers					
United States	**1,259,858**	1,355,289	1,397,452	1,463,497	1,328,959
Canada	**550,302**	525,831	495,610	479,125	446,131
Home health care – Canada	**170,343**	165,030	157,177	155,096	148,928
Health technology services – United States	**25,453**	19,120	17,205	18,853	14,328
Outpatient therapy – United States	**13,229**	13,750	12,603	13,905	12,956
Rent, management, consulting and other services	**18,228**	15,062	17,369	31,091	31,567
	2,037,413	2,094,082	2,097,416	2,161,567	1,982,869
EBITDA[2]	**183,253**	200,136	242,070	265,670	201,827
Earnings from continuing operations before separately reported items[2]	**29,532**	6,986	39,378	59,165	29,345
Net earnings (loss)	**62,656**	(30,396)	41,829	77,708	13,388
AFFO[2]	**84,569**	69,847	110,736	146,137	78,794
AFFO per basic share/unit *($)*	**0.99**	0.84	1.36	2.00	1.09
Distributions declared per share/unit *($)*	**0.84**	0.84	0.84	0.84	1.11
Distribution payout ratio *(% of AFFO)*	**85**	100	62	42	102
Average U.S./Canadian dollar exchange rate	**0.9996**	0.9891	1.0299	1.1420	1.0660
Other Information					
Number of centers operated *(year end)*					
United States	**158**	179	181	176	185
Canada	**88**	82	85	82	81
	246	261	266	258	266
Operational resident capacity *(year end)*					
United States	**15,361**	17,369	17,658	17,295	18,634
Canada	**11,467**	10,738	11,789	11,523	11,394
	26,828	28,107	29,447	28,818	30,028
U.S. nursing center average daily census by payor source *(%)*					
Medicare	**15.8**	16.8	16.4	16.2	17.2
Managed Care	**6.0**	6.0	5.7	5.7	5.2
Skilled Mix	**21.8**	22.8	22.1	21.9	22.4
Private/other	**10.1**	9.9	10.5	10.7	11.1
Medicaid	**68.1**	67.3	67.4	67.4	66.5
U.S. nursing center revenue by payor source *(%)*					
Medicare	**31.0**	34.9	33.3	32.9	33.7
Managed Care	**10.1**	10.0	9.5	9.6	8.6
Skilled Mix	**41.1**	44.9	42.8	42.5	42.3
Private/other	**9.2**	8.5	9.2	9.3	9.7
Medicaid	**49.7**	46.6	48.0	48.2	48.0
Average occupancy – U.S. nursing centers *(%)*	**85.2**	85.7	86.0	87.9	88.0
Average occupancy – Canadian centers *(%)*	**98.0**	96.9	98.0	98.1	98.0
ParaMed home health care hours of service	**4,796,000**	4,634,000	4,402,000	4,554,000	4,495,000
Number of employees *(year end)*	**35,700**	38,100	37,700	38,000	39,100
Number of shares/units outstanding *(year end)*	**85,989,376**	84,121,488	82,995,181	73,180,024	73,572,418

(1) The selected information presented for 2009 and 2008 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 62.

Securityholder Information

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Transfer Agent

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Tel: (800) 564-6253
Fax: (866) 249-7775
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

2012 Extendicare share/unit trading:
High: $8.94; Low: $6.80
Close: $7.65; Volume: 51,778,871

Shareholder Inquiries/ Investor Relations

Jillian Fountain
Corporate Secretary

Tel: (905) 470-5534
Fax: (905) 470-4003

email: jfountain@extendicare.com

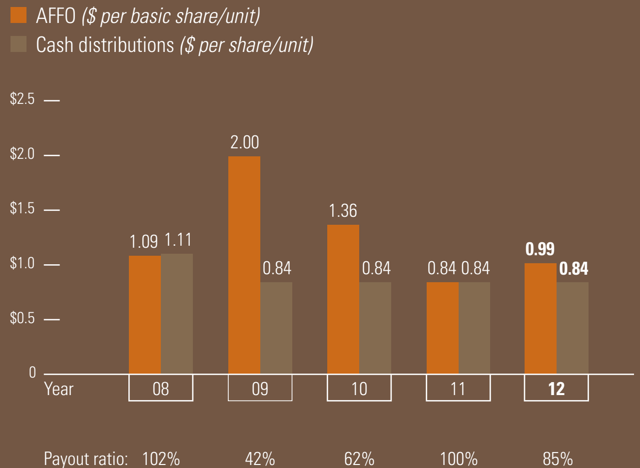
Annual Meeting

Shareholders are invited to attend the Annual Meeting of Extendicare Inc. on May 9, 2013 at 2:30 p.m., at The Gallery, TMX Broadcast Centre, 130 King Street West, Toronto, Ontario, Canada

Published Information

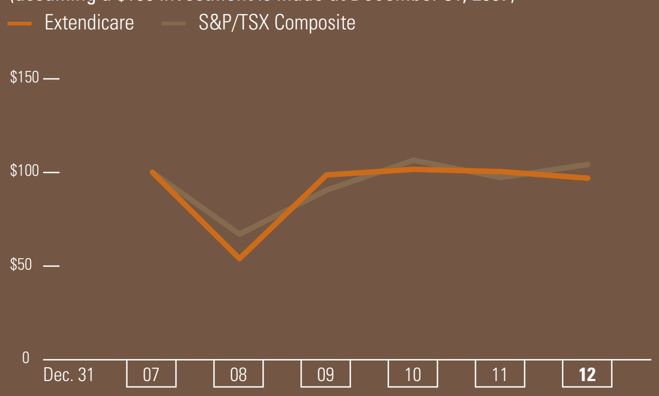
Extendicare Inc.'s 2012 Annual Report is available for viewing or printing on its website at www.extendicare.com, together with news releases, quarterly reports and other filings with the securities commissions. Printed copies of the annual report are available upon request to the Corporate Secretary.

Extendicare AFFO and Cash Distributions[1]



(1) The AFFO for 2009 and 2008 were prepared under previous Canadian GAAP.

Relative Share Price Performance
(assuming a $100 investment is made at December 31, 2007)



An artist's rendition of Extendicare's Maple View of Sault Ste. Marie, a 256-bed long-term care center in Ontario, Canada, scheduled to open in April 2013.

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... helping people live better

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