MANAGEMENT'S DISCUSSION AND ANALYSIS

Year Ended December 31, 2017

Dated: February 28, 2018

The Right Care – The Right Time – The Right Place

Management's Discussion and Analysis

February 28, 2018

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BASIS OF PRESENTATION

This Management's Discussion and Analysis (MD&A) provides information on Extendicare Inc. 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 Company's common shares (the "Common Shares") are listed on the Toronto Stock Exchange (TSX) under the symbol "EXE". The registered office of Extendicare is located at 3000 Steeles Avenue East, Suite 700, Markham, Ontario, Canada, L3R 9W2.

Extendicare and its predecessors have been in operation since 1968, providing care and services to seniors throughout Canada. Following the sale of substantially all of its U.S. business in 2015 and the repositioning of the Company as a pure-play Canadian services provider to the expanding senior care sector, we have continued to grow the Company's operations across the continuum of seniors' care.

In July 2015, Extendicare completed the sale of substantially all of its U.S. business and senior care operations (the "U.S. Sale Transaction"), which were conducted through its wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries. In December 2016, the Company disposed of its non-strategic U.S. information technology hosting and professional services (U.S. IT Hosting) business. The operating results of the disposed U.S. operations are reported as discontinued operations throughout this MD&A.

Extendicare has prepared this MD&A to provide information to current and prospective investors of the Company to assist them to understand Extendicare's financial results for the year ended December 31, 2017. This MD&A should be read in conjunction with Extendicare's audited consolidated financial statements for the years ended 2017 and 2016, and the notes thereto, prepared in accordance with International Financial Reporting Standards (IFRS). These financial statements and notes are available on Extendicare's website at www.extendicare.com. All currencies are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2017, or December 31 of the year referenced.

The discussion and analysis in this MD&A are based upon information available to management as of February 28, 2018. 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 events may or may not occur, which could affect the Company in the future.

ADDITIONAL INFORMATION

Additional information about Extendicare, including its latest Annual Information Form, may be found on SEDAR's website at www.sedar.com under Extendicare's issuer profile and on Extendicare's website at www.extendicare.com. A copy of this and other public documents of Extendicare are available upon request to the Corporate Secretary of Extendicare.

FORWARD-LOOKING STATEMENTS

Information provided by Extendicare from time to time, including in this Annual Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to the Company, including, without limitation, statements regarding its business operations, business strategy, growth strategy, results of operations and financial condition; statements relating to indemnification provisions and deferred consideration in respect of the U.S. Sale Transaction; and the acquisition and development of retirement communities, including statements related to the expected annual revenue, net operating income (NOI) yield, and adjusted funds from operations to be derived from acquisitions and development projects. Forward-looking statements can be identified by the expressions "anticipate", "believe", "estimate", "expect", "intend", "objective", "plan", "project", "will" 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 and are inherently subject to significant business, economic and competitive uncertainties and contingencies. In addition to the assumptions and other factors referred to specifically in connection with these forward-looking statements, the risks, uncertainties and other 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, 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 health care and long-term care industries and the compliance by Extendicare with such regulations; changes in government funding levels for health care services; changes in tax laws; resident care and class action litigation, including the Company's exposure to punitive damage claims, increased insurance costs and other claims; the ability of Extendicare to maintain and increase resident occupancy levels and home health care volumes; changes in competition; changes in demographics and local environment economies; changes in foreign exchange and interest rates; changes in the financial markets, which may affect the ability of Extendicare to refinance debt; and the availability and terms of capital to Extendicare to fund capital expenditures and acquisitions; changes in the anticipated outcome and benefits of dispositions, acquisitions and development projects, including risks relating to completion; and those other risks, uncertainties and other factors identified in the Company's other public filings with the Canadian securities regulators available on SEDAR's website at www.sedar.com under Extendicare's issuer profile.

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 obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

NON-GAAP MEASURES

Extendicare assesses and measures operating results and financial position based on performance measures referred to as "net operating income", "net operating income margin", "EBITDA", "Adjusted EBITDA", "Adjusted EBITDA margin", "earnings before depreciation, amortization, and other expense", "earnings (loss) from continuing operations before separately reported items, net of taxes", "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. In addition, the Company assesses its return on investment in development activities using the non-GAAP financial measure "NOI Yield". 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 for users of the financial statements to assess the Company's operating performance and ability 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”, or “NOI”, in this document are to revenue less operating expenses, and this value represents the underlying performance of our operating business segments. References to “net operating income margin” are to net operating income as a percentage of revenue.

References to “EBITDA” in this document are to earnings (loss) from continuing operations before net finance costs, income taxes, depreciation and amortization. References to “Adjusted EBITDA” in this document are to EBITDA adjusted to exclude the line item “other expense”, and as a result, is equivalent to the line item “earnings before depreciation, amortization, and other expense” reported on the consolidated statements of earnings. References to “Adjusted EBITDA Margin” are to Adjusted EBITDA as a percentage of revenue. Management believes that certain lenders, investors and analysts use EBITDA and Adjusted EBITDA to measure a company’s ability to service debt and meet other payment obligations, and as a common valuation measurement in the long-term care industry. For example, certain of our debt covenants use Adjusted EBITDA in their calculations.

References to “earnings (loss) from continuing operations before separately reported items, net of tax” in this document are to earnings (loss) from continuing operations, excluding the following separately reported line items: “fair value adjustments”, “loss (gain) on foreign exchange”, and “other expense”. 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, and interest rate agreements, 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 acquisition related costs, restructuring charges, proxy contest costs, 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 (loss) from operations and related earnings per share excluding such items.

“Funds from Operations”, or “FFO”, is defined as Adjusted EBITDA less depreciation for furniture, fixtures, equipment and computers, or “depreciation for FFEC”, accretion costs, net interest expense, and current income taxes. Depreciation for FFEC is considered representative of the amount of maintenance (non-growth) capital expenditures, or “maintenance capex”, to be used in determining “Funds from Operations”, as the depreciation term is generally in line with the life of these assets. FFO is a recognized earnings measure that is widely used by public real estate entities, particularly by those entities that own and/operate income-producing properties. Management believes that certain investors and analysts use FFO, and as such has included FFO to assist with their understanding of the Company’s operating results.

“Adjusted Funds from Operations”, or “AFFO”, is defined as FFO plus: i) the reversal of non-cash financing and accretion costs; ii) the reversal of non-cash share-based compensation; iii) the principal portion of government capital funding; iv) amounts received from income support arrangements; and v) the reversal of income or loss of the captive insurance company that was included in the determination of FFO, as those operations are funded through investments held for U.S. self-insured liabilities, which are not included in the Company’s reported cash and short-term investments. In addition, AFFO is further adjusted to account for the difference in total maintenance capex incurred from the amount deducted in the determination of FFO. Since our actual maintenance capex spending fluctuates on a quarterly basis with the timing of projects and seasonality, the adjustment to AFFO for these expenditures from the amount of depreciation for FFEC already deducted in determining FFO, may result in an increase to AFFO in the interim periods reported. Management believes that AFFO is a relevant measure of the ability of the Company to earn cash and make cash distributions to shareholders.

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.

References to “payout ratio” in this document are to the ratio of dividends declared per share to AFFO per basic share.

References to “NOI Yield” in this document are to a financial measure used by the Company to assess its return on investment in development activities. NOI Yield is defined by the Company as the estimated stabilized NOI of a development property in the first year it achieves expected stabilized occupancy divided by the estimated Adjusted Development Costs, as defined below. Management believes that this is a relevant measure of the Company’s total economic return of a development project.

“Adjusted Development Costs” is defined as development costs on a GAAP basis (which includes the cost of land, hard and soft development costs, furniture, fixtures and equipment) plus/minus cumulative net operating losses/earnings generated by the development property prior to achieving expected stabilized occupancy, plus an estimated imputed cost of capital during the development period through to the expected stabilized occupancy.

Reconciliations of “earnings (loss) from continuing operations before income taxes” to “Adjusted EBITDA” and “net operating income” are provided under the headings “2017 Selected Quarterly Information”, “2017 Fourth Quarter Financial Review” and “2017 Financial Review”.

Reconciliations of “earnings from continuing operations” to “FFO” and “AFFO” are provided under the heading “Adjusted Funds from Operations”.

Reconciliations of “net cash from operating activities” to “AFFO” are provided under the heading “Adjusted Funds from Operations – Reconciliation of Net Cash from Operating Activities to AFFO”.

BUSINESS STRATEGY

Our strategy is to be the leading provider of care and services to seniors in Canada. To do this, we strive to provide quality, person-centred care through compassionate caregivers across the continuum of care. We have complemented our core long-term care services through the growth of our home health care operations and expansion into the private-pay retirement sector. We intend to continue to grow our private-pay home health care services and retirement business lines through acquisition and development, as well as supporting continued growth in our management, consulting and group purchasing divisions. In doing so, we intend to diversify our revenue streams to achieve a better balance between government and privately funded activities.

Our goal is to be well-positioned geographically, and from a service delivery standpoint, to be able to offer the right care, at the right time, in the right place for Canadian seniors as they age and their care and service needs change.

We will continue to emphasize quality, transparency and communication with our customers and stakeholders in order to continue to be viewed as a leader in the Canadian senior care sector. To accomplish this strategy, we want to be a health care employer of choice in the communities in which we operate. We know that we are only as good as the care and customer service being provided by each of our employees on a daily basis.

By executing this strategy effectively, we believe we can provide an appropriate and consistent return to our shareholders who have demonstrated their belief in our mission by investing in Extendicare.

SIGNIFICANT 2017 EVENTS AND DEVELOPMENTS

This section provides an update on our current activities related to the continued expansion into the Canadian retirement sector. Refer to the discussion under the heading “Other Significant Developments” for a summary of other developments affecting the financial results or operations of Extendicare.

Growth of Retirement Operations

As part of the execution of our strategy to continue to grow along the senior care and services continuum, we continue to expand our private-pay retirement operations through the acquisition and development of retirement communities under our Esprit Lifestyle Communities brand. Our retirement communities offer independent and enhanced living and memory care, as well as short-term stay, and respite care.

Since 2015, we have acquired six retirement communities, completed the development of Cedar Crossing Retirement Community (Cedar Crossing) in Simcoe, Ontario, that opened in the fourth quarter of 2016, and completed the first phase of Douglas Crossing Retirement Community (Douglas Crossing) in Uxbridge, Ontario, that opened in the fourth quarter of 2017.

RETIREMENT ACQUISITIONS

On February 23, 2018, the Company entered into a definitive agreement to acquire the Lynde Creek Retirement Community, located in Whitby, Ontario, for a cash purchase price of $34.5 million, subject to normal closing adjustments. The acquired community consists of the Lynde Creek Manor Retirement Residence, offering 93 independent and assisted living suites, (the “Manor”); the Lynde Creek Life Lease Village, with 113 townhomes, (the “Village”); and 3.7 acres of adjacent land for expansion (the “Excess Land”). Closing, which is subject to customary conditions, is expected to occur in the second quarter of 2018.

The Manor is a modern private pay luxury retirement residence with 93 suites offering independent supportive living (ISL) and assisted living (AL) suites, and is currently 100% occupied. The Village is a 113-unit townhome development that sits adjacent to the Manor. Included in the purchase agreement is the ownership of the underlying land and the leasehold interest related to the life leases. Upon the resale of a townhome, the Company retains a 10% residual interest in the proceeds. The Excess Land is situated immediately adjacent to the Manor, with zoning that allows for a strategic expansion to include additional ISL/AL suites or seniors apartments units.

PROJECTS IN DEVELOPMENT

In October 2017, we opened the initial 103 suites of our Douglas Crossing Retirement Community, in Uxbridge, Ontario. As a result of the robust pre-lease activity at Douglas Crossing, we have accelerated our expansion plans for this community, and are in the process of completing a 47-suite addition that is anticipated to be completed in late 2018. As well, construction is under way on our Bolton (112 suites) and Barrie (124 suites) retirement projects, which are anticipated to open in the fourth quarter of 2018, and the 2019 second quarter, respectively.

The following table summarizes these projects that are in various stages of development, and provides our expected stabilized occupancy, estimated Adjusted Development Costs, estimated stabilized NOI, and corresponding NOI Yield. The NOI Yield is a non-GAAP financial measure that we use to assess our return on investment. Refer to the discussion under the heading “Non-GAAP measures”.

Name/Location	**# of Suites**	**Actual / Expected Opening**	**Expected Stabilized Occupancy Date**	**Expected Stabilized Occupancy** *(%)*	**Estimated Adjusted Development Costs** *(millions)*	**Estimated Stabilized NOI** *(millions)*	**Expected NOI Yield**
Douglas Crossing, Uxbridge, ON							
Phase I	103	Oct. 30/17					
Phase II	47	Q4/2018	Q1/2020	93%	$40.3	$3.5	8.6%
Bolton, ON	112	Q4/2018	Q4/2021	95%	$31.5	$2.4	7.6%
Barrie, ON	124	Q2/2019	Q4/2021	92%	$39.7	$3.2	8.0%

RETIREMENT COMMUNITY FINANCINGS

As at December 31, 2017, the Company had construction financing available for its Cedar Crossing, Douglas Crossing, and Bolton retirement development projects of up to $9.9 million, $29.7 million, and $20.8 million, respectively, of which an aggregate of $29.9 million was drawn (2016 – $12.6 million). Loan payments are interest-only, based on a variable 30-day banker’s acceptance rate plus 2.5%, with no standby fee. The construction loans are repayable on demand by the lender and, in any event, are to be fully repaid as follows: Cedar Crossing, in November 2018 (being 24 months from the issuance of the occupancy permit); Douglas Crossing, in October 2021 (being 60 months from close of the loan); and Bolton, by the earlier of April 2022 or 36 months from the issuance of the occupancy permit. We anticipate securing construction financing under similar terms for the Barrie project. Permanent financing for each of the communities will be sought upon maturity of the construction financing.

In August 2016, the Company secured financing on three of the retirement communities that had been acquired in 2015, representing non-revolving credit facilities aggregating $56.3 million (the “Retirement Mortgages”). These financings have seven-year terms, and bear interest at variable rates of prime plus 0.5% or 30-day banker’s acceptance rate plus 1.9%. In conjunction with securing the Retirement Mortgages, the Company entered into interest rate swap contracts to lock in the rates at 3.11% for the full term. These interest rate swap contracts are measured at fair value through profit or loss.

BUSINESS OVERVIEW

Extendicare, through its subsidiaries, is the largest private-sector operator of long-term care centres in Canada and we believe is the largest private-sector provider of publicly funded home health care services in Canada through our wholly owned subsidiary ParaMed Inc. (ParaMed). In addition, the Company owns and operates retirement communities under the Esprit Lifestyle Communities brand, provides management and consulting services to third-party owners of senior care and living centres through its Extendicare Assist division, and provides group purchasing services to third-party clients through its SGP Purchasing Partner Network division. In 2017, approximately 56% of the revenue from our Canadian operations was derived from our long-term care operations, approximately 40% was from our home health care business, approximately 2% was from our retirement living operations, and the balance was from our management, consulting and group purchasing operations.

As at December 31, 2017, Extendicare owned and operated 58 LTC centres, 8 retirement communities, and managed 50 senior care and living centres for third parties. In total, we operated 116 senior care and living centres across four provinces in Canada, with capacity for 15,004 residents, with a significant presence in Ontario and Alberta, where approximately 76% and 11% of its residents, respectively were served. ParaMed's home health care services operated from 35 locations across six provinces providing approximately 11.3 million hours of service annually. SGP Purchasing Partner Network provided group purchasing services to third-party clients representing over 45,200 seniors across Canada. In all, as at December 31, 2017, the Company employed approximately 23,700 individuals across Canada that are dedicated to helping people live better through a commitment to quality service and passion for what we do.

The table below summarizes the senior care and living centres operated by Extendicare, including those managed for third parties, as at December 31, 2017. The Company operates nine of its Ontario LTC centres under 25-year finance lease arrangements, with full ownership obtained at the end of the lease term. Extendicare believes that ownership of its centres provides financial and strategic advantages.

	Long-term Care		**Retirement Living**		**Chronic Care Unit**		**Total**	
By Province	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**
Owned/Leased								
Ontario	34	5,206	4	335	–	–	38	5,541
Alberta	14	1,495	–	–	–	–	14	1,495
Saskatchewan	5	649	4	341	–	–	9	990
Manitoba	5	762	–	–	–	–	5	762
	58	8,112	8	676	–	–	66	8,788
Managed								
Ontario	40	5,165	5	552	1	120	46	5,837
Alberta	1	102	1	109	–	–	2	211
Manitoba	2	168	–	–	–	–	2	168
	43	5,435	6	661	1	120	50	6,216
Total	**101**	**13,547**	**14**	**1,337**	**1**	**120**	**116**	**15,004**

(1) The centres are categorized based on the predominant level of care provided, the type of licensing and the type of funding provided. For example, two of our long-term care centres with retirement wings have been categorized as LTC centres. In addition, government-funded supportive living suites have been categorized as LTC centres due to the nature of the regulatory oversight and government-determined fee structure.

The following reflects the change in operating capacity of our Canadian senior care and living centres during 2017 and 2016.

	2017		**2016**	
Senior Care Centres	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**
As at beginning of year	**118**	**15,022**	116	14,890
Managed contracts added	**7**	**764**	1	41
Managed contracts ceased	**(10)**	**(900)**	(2)	(135)
Retirement communities acquired/developed	**1**	**103**	3	226
Operational capacity adjustments	**–**	**15**	–	–
As at end of year	**116**	**15,004**	118	15,022

Operating Segments

The Company reports the following segments within its Canadian operations: i) long-term care; ii) retirement living; iii) home health care; iv) management, consulting and group purchasing as "other Canadian operations"; and v) the Canadian corporate functions and any intersegment eliminations as "corporate Canada". For financial reporting purposes, the Company's owned and operated centres are reported under the "long-term care" or the "retirement living" operating segment based on the predominate level of care provided. The Company's managed centres are reported under the "other Canadian operations" segment, as the revenue from those operations is earned on a fee-for-service basis.

The Company continues to group its former and remaining U.S. operations as one segment, consisting of its wholly owned Bermuda-based captive insurance company, Laurier Indemnity Company, Ltd. (the "Captive") that insured Extendicare's U.S. general and professional liability risks up to the date of the U.S. Sale Transaction. The Captive's expense incurred or release of reserves for self-insured liabilities as well as the disposed U.S. businesses are presented as discontinued operations; while the Captive's costs to administer and manage the settlement of the remaining claims are reported as continuing operations within the U.S. segment.

The following describes the continuing businesses and operating segments of Extendicare.

LONG-TERM CARE (including government-funded supportive living)

Extendicare owns and operates for its own account 58 LTC centres with capacity for 8,112 residents, inclusive of a stand-alone designated supportive living centre (140 suites) and a designated supportive living wing (60 suites) in Alberta, and two retirement wings (76 suites) in Ontario. Revenue from the long-term care operations represented 56.2% of consolidated revenue from continuing operations in 2017 (2016 – 57.4%).

In Canada, provincial legislation and regulations closely control all aspects of operation and funding of LTC centres, including the fee structure, subsidies, the adequacy of physical centres, standards of care and accommodation, equipment and personnel. A substantial portion of the long-term care fees paid to providers of these services are funded by provincial programs, with a portion to be paid by the resident. Nobody is refused access to long-term care due to an inability to pay. A government subsidy, generally based on an income test, is available for residents who are unable to afford the resident co-payment. In Alberta, designated supportive living centres provide services similar to those provided by retirement communities, and were introduced by AHS as an alternative setting for residents not yet requiring the needs of a more expensive LTC centre. The designated supportive living operations are licensed, regulated and funded by AHS, in a similar manner to LTC centres, including a government-determined fee structure.

In Ontario, operators have the opportunity to receive additional funding through higher accommodation rates charged to residents for private and semi-private accommodation, at maximum preferred accommodation rates that are fixed by the government. Operators are permitted to designate up to 60% of the resident capacity of a centre as preferred accommodation and charge higher accommodation rates that vary according to the structural classification of the LTC centre.

The following summarizes the composition of the owned/leased LTC centres operated by Extendicare in Ontario, as at December 31, 2017, as well as the maximum preferred differential rates for each classification of bed.

					Composition of Beds	
Ontario Owned/Leased	**No. of Centres**	**Private $25.63 premium**	**Private $18.45 premium**	**Semi-private $8.20 premium**	**Basic/Other**	**Total**
New	13	1,099	–	–	748	1,847
Class C [(1)]	21	–	476	1,396	1,411	3,283
	34	1,099	476	1,396	2,159	5,130

(1) Beds in operation of 3,283 exclude 4 beds held in abeyance.

RETIREMENT LIVING

Through its subsidiaries, Extendicare owns and operates retirement communities under the Company's Esprit Lifestyle Communities brand. As at December 31, 2017, eight retirement communities (676 suites) were in operation, four of which are located in Saskatchewan (341 suites) and four are located in Ontario (335 suites). In October 2017, we completed construction of and opened the first phase of a retirement community in Uxbridge, Ontario (103 suites), with a further 47 suites to be completed by the end of 2018. In addition, we have two retirement communities (236 suites) under development in Ontario that are scheduled to open in 2018 and 2019.

Extendicare's retirement communities provide services to private-pay residents at rates set by Extendicare based on the services provided and market conditions. The monthly fees vary depending on the type of accommodation, level of care and services chosen by the resident, and the location of the retirement community. Residents are free to choose the living arrangements best suited to their personal preference and needs and, more importantly, change the level of care and support they receive as their needs evolve over time. Revenue from these operations represented 1.9% of consolidated revenue from continuing operations in 2017 (2016 – 1.5%).

HOME HEALTH CARE

Extendicare provides home health care services through ParaMed, whose professionals and staff members are skilled in providing complex nursing care, occupational, physical and speech therapy, and assistance with daily activities to accommodate clients of all ages living at home. Revenue from these operations represented 39.7% of consolidated revenue from continuing operations in 2017 (2016 – 39.1%).

Provincial governments fund a wide range of home health care services, and contract these services to providers such as ParaMed. In 2017, ParaMed received approximately 98% of its revenue from contracts tendered by locally administered provincial agencies (2016 – 97%), with the remainder from private-pay clients. ParaMed operates from 35 locations in six provinces across Canada (29 in Ontario, 1 in British Columbia, 2 in Alberta, 1 in Manitoba, 1 in Nova Scotia, and 1 in Quebec), providing approximately 11.3 million hours of service annually. During 2017, approximately 83% of ParaMed's hours of service were provided in Ontario, 12% were provided in British Columbia, 4% in Alberta, and the balance were provided in Manitoba, Nova Scotia and Quebec.

OTHER CANADIAN OPERATIONS

Extendicare's other Canadian operations are composed of its management and consulting services provided by Extendicare Assist, and group purchasing services provided by SGP Purchasing Partner Network. Revenue from these two operations, collectively, represented 1.7% of consolidated revenue from continuing operations in 2017 (2016 – 1.7%).

Management and Consulting Services

Through its Extendicare Assist division, Extendicare has leveraged its expertise in operating senior care centres by providing a wide range of management and consulting services to third-party owners. Extendicare Assist partners with not-for-profit and for-profit organizations, hospitals and municipalities that seek to improve their management practices, levels of care and operating efficiencies. Most of the contracts include management, accounting and purchasing services, staff training, reimbursement assistance, and, where applicable, the implementation of Extendicare's policies and procedures. In addition, Extendicare Assist provides consulting services to third parties in respect of development and redevelopment projects in the long-term care sector.

As a skilled manager and operator of senior care centres for third parties, Extendicare Assist's managed portfolio consisted of 50 senior care centres with capacity for 6,216 residents as at December 31, 2017 (December 31, 2016 – 53 centres with capacity for 6,332 residents). Contracts to manage eight centres (751 beds) and two centres (149) ceased in January and May 2017, respectively, following the sale of the centres to new operators. During 2017, we secured new contracts to manage seven centres; one took effect in January (112 beds), five took effect in May (492 beds), and one in November (160 beds). Extendicare Assist has subsequently secured contracts to manage three additional centres (416 beds) that are expected to transition in March.

Group Purchasing Services

Through its SGP Purchasing Partner Network division (SGP), Extendicare offers cost-effective purchasing contracts to other senior care providers for food, capital equipment, furnishings, cleaning and nursing supplies, and office products. SGP negotiates long-term and high volume contracts with its suppliers that provide members with preferred pricing, thereby providing a cost-effective way to secure quality national brand-name products, along with a range of innovative services. As at December 31, 2017, SGP provided services to third-party clients with capacity for approximately 45,200 residents (December 31, 2016 – 40,900 residents).

U.S. REMAINING OPERATIONS – CAPTIVE INSURANCE COMPANY

Prior to the U.S. Sale Transaction, Extendicare self-insured certain risks related to general and professional liability of its disposed U.S. operations through the Captive. The obligation to settle any such claims relating to the period prior to the closing of the U.S. Sale Transaction, including claims incurred but yet to be reported, remains with Extendicare, which it intends to fund through the Captive. The majority of the risks that Extendicare self-insured relating to the U.S. operations are long-term in nature, and accordingly, claim payments for any particular policy year can occur over a long period of time. In addition, through the Captive, the Company maintained third-party liability insurance on a "claims made" basis, as opposed to "occurrence based" coverage, meaning that some level of coverage may continue to be required. Any expense incurred or release of reserves for U.S. self-insured liabilities are presented as discontinued operations; while the costs to administer and manage the settlement of the remaining claims are reported as continuing operations within the U.S. segment.

As at December 31, 2017, the accrual for U.S. self-insured general and professional liabilities was $61.1 million (US$48.6 million) compared to US$70.6 million at the beginning of the year, and the investments held for U.S. self-insured liabilities totalled $86.3 million (US$68.6 million) compared to US$101.4 million at the beginning of the year, with the decline in each reflecting the "run off" of these operations. During 2017, following the completion of independent actuarial reviews, the Company released US$4.4 million of reserves for self-insured liabilities, bringing the total released since the sale of the U.S. operations in 2015 to US$19.7 million. Following the release of these reserves, the Captive has transferred US$21.0 million of its funds previously held for investment to the Company for general corporate use, of which US$16.0 million was transferred in 2017 and US$5.0 million was transferred in 2016. The loss provisions for our U.S.

general and professional liability risks are based upon management's best available information, including independent actuarial estimates. The Captive is currently appropriately capitalized, but there can be no assurance that it will remain as such in the future should general and professional liability claims incurred prior to the closing of the U.S. Sale Transaction, including claims incurred but yet to be reported, increase significantly. For further information on our self-insured liabilities, refer to the discussion under the heading "Accrual for U.S. Self-insured Liabilities" found within the "Liquidity and Capital Resources" section of this MD&A.

KEY PERFORMANCE INDICATORS

In addition to those measures identified under the heading "Non-GAAP Measures", management uses certain key performance indicators in order to compare the financial performance of Extendicare's continuing operations between periods. In addition, we assess the operations on a same-store basis between the reported periods. Such performance indicators may not be comparable to similar indicators presented by other companies. Set forth below is an analysis of the key performance indicators and a discussion of significant trends when comparing Extendicare's financial results from continuing operations.

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

"Stabilized community" is the classification by the Company of a retirement community that has achieved its expected stabilized occupancy level, which varies from project to project; such operations in respect of this report specifically refer to three retirement communities (Empire Crossing, Stonebridge Crossing and Riverbend Crossing);

"Non same-store" or "NSS", generally refers to those centres or business that were not continuously operated by us since the beginning of the previous fiscal year or have been classified as held for sale, such operations in respect of this report specifically refer to four retirement communities that were acquired or opened during 2016 and 2017 (Yorkton Crossing, West Park Crossing, Cedar Crossing and Douglas Crossing);

"Occupancy" is measured as the percentage of the number of earned resident days (or the number of occupied suites in the case of a retirement community) relative to the total available resident days. Total available resident days is the number of beds (or suites in the case of a retirement community) available for occupancy multiplied by the number of days in the period; and

"Same-store" or "SS" generally refers to those centres or businesses that were continuously operated by us since the beginning of the previous fiscal year, and which are not classified as held for sale; such operations in respect of this report specifically refer to all continuing operations excluding the four retirement communities acquired or opened during 2016 and 2017.

Long-term Care

The average occupancy at our LTC centres was 97.7% this quarter compared to 97.9% in the 2016 fourth quarter, and for the year was 97.7% compared to 98.0% in 2016. 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 outbreaks, which can lead to temporary freezes on admissions.

In Ontario, overall government funding is occupancy-based, but once the average occupancy level of 97% or higher for the calendar year is achieved, operators receive government funding based on 100% occupancy. In 2017, Extendicare's LTC centres in Ontario achieved an overall average occupancy of 98.1%, with all but two of the centres achieving the 97% occupancy threshold.

In addition, Extendicare's Ontario LTC centres receive premiums for preferred accommodation. The average occupancy of the private beds in our "New" centres improved to 98.1% this quarter from 97.2% in the 2016 fourth quarter, and for the year improved to 97.9% from 96.8% in 2016. The average occupancy of the private beds at our Class C centres improved to 98.8% this quarter from 97.9% in the 2016 fourth quarter, and for the year improved to 98.4% from 98.7% in 2016. This decline was primarily due to admissions challenges at one of our LTC centres, which we anticipate will recover next year.

The following table provides the average occupancy levels of our LTC operations for the past eight quarters.

					2017					2016
Long-term Care Centres	**Q1**	**Q2**	**Q3**	**Q4**	**Year**	**Q1**	**Q2**	**Q3**	**Q4**	**Year**
Average Occupancy *(%)*										
Total LTC	**97.2%**	**97.6%**	**98.2%**	**97.7%**	**97.7%**	98.0%	97.9%	98.1%	97.9%	98.0%
Ontario LTC										
Total operations	**97.6%**	**98.2%**	**98.5%**	**98.2%**	**98.1%**	98.5%	98.5%	98.6%	98.2%	98.5%
Preferred Accommodation (1)										
New centres – private	**97.1%**	**98.0%**	**98.3%**	**98.1%**	**97.9%**	96.4%	96.8%	96.9%	97.2%	96.8%
Class C centres – private	**98.5%**	**98.3%**	**97.8%**	**98.8%**	**98.4%**	99.1%	99.2%	98.7%	97.9%	98.7%
Class C centres – semi-private	**64.5%**	**65.7%**	**67.3%**	**66.5%**	**66.1%**	63.5%	64.3%	64.8%	65.0%	68.4%

(1) Average occupancy reported for the available private and semi-private rooms reflects the percentage of residents occupying those beds and paying the respective premium rates.

Retirement Living

Our retirement living operating segment consists of eight retirement communities in operation, four of which are classified as non same-store, representing two newly developed communities acquired in February 2016, and two that we developed and opened in November 2016 and October 2017, respectively. All of the retirement communities in operation were in lease-up during 2016. Three of the communities that were acquired in 2015, Empire, Stonebridge and Riverbend, are now considered stabilized communities, having reached their expected stabilized occupancy levels by the end of 2017.

AS AT OCCUPANCY

The following table provides the combined occupancy of our stabilized and lease-up retirement communities as at the end of each quarter in 2017, and as at the end of each of 2016.

Retirement Communities				**2017**	**2016**
As at Occupancy:	**Mar. 31**	**Jun. 30**	**Sept. 30**	**Dec. 31**	**Dec. 31**
Stabilized communities (Empire/Stonebridge/Riverbend)	**90.7%**	**90.2%**	**95.9%**	**95.9%**	93.9%
Lease-up communities	**47.3%**	**50.6%**	**61.3%**	**68.6%**	41.5%

The occupancy of the three stabilized communities improved to an average of 95.9% as at December 31, 2017, from 93.9% at the end of 2016. The decline experienced in early 2017 was due to higher attrition through the winter months. The occupancy of the five lease-up communities improved to an average of 68.6% as at December 31, 2017, up from 61.3% at September 30, 2017, notwithstanding the opening of a new 103-suite retirement community, Douglas Crossing, at the end of October.

AVERAGE OCCUPANCY

The following table provides the average occupancy of the retirement communities in total and for each of the stabilized and lease-up groupings, reflecting improvements throughout 2017.

					2017					2016
Retirement Communities	**Q1**	**Q2**	**Q3**	**Q4**	**Year**	**Q1**	**Q2**	**Q3**	**Q4**	**Year**
Average Occupancy *(%)* – total	**63.4%**	**66.6%**	**71.9%**	**75.9%**	**69.7%**	61.2%	53.8%	61.0%	63.0%	59.8%
Stabilized communities	**87.6%**	**88.1%**	**92.1%**	**95.5%**	**90.8%**	77.2%	76.9%	84.4%	87.6%	81.5%
Lease-up communities	**45.2%**	**50.6%**	**56.7%**	**63.8%**	**54.6%**	37.4%	31.7%	38.5%	41.7%	37.5%

Home Health Care

Revenue from provincial programs represented approximately 98% of Extendicare's home health care revenue in 2017 (2016 – 97%). ParaMed's average daily hours of service declined this quarter by 1.0% to 30,634 from 30,932 in the 2016 fourth quarter, with improvements in the Ontario volumes, offset by reductions in other provinces. In terms of the quarterly trends throughout 2017, the decline in volumes experienced in the third and fourth quarters of 2017 is not unusual due to a combination of seasonality generally experienced during the summer months and the impact of provincial agencies managing their budgets throughout the year. We also experienced a decline in our Ontario volumes during the summer months of 2016; however, the impact was offset by our expanded business in British Columbia that quarter. For 2017, our average daily hours of service increased by 4.1% to 31,032 from 29,807 in 2016, reflecting the government's commitment to allocate additional funds to this segment of the Canadian health care system, and we anticipate ParaMed's business will continue to grow. For further information on the home health care operations, refer to the discussion under the heading "Update of Regulatory and Funding Changes Affecting Results – Ontario Home Health Care Legislation and Funding".

The following table provides the service volumes of our home health care operations for the past eight quarters.

Home Health Care Service Volumes	2017 Q1	2017 Q2	2017 Q3	2017 Q4	2017 Year	2016 Q1	2016 Q2	2016 Q3	2016 Q4	2016 Year
Hours of service (000's)	**2,815.7**	**2,859.1**	**2,833.6**	**2,818.4**	**11,326.8**	2,625.1	2,666.4	2,772.0	2,845.8	10,909.3
Hours per day	**31,285**	**31,418**	**30,800**	**30,634**	**31,032**	28,847	29,302	30,130	30,932	29,807

2017 SELECTED ANNUAL INFORMATION

The following is a summary of selected annual financial information for each of the past three years.

(thousands of dollars unless otherwise noted)	2017	2016	2015
Financial Results			
Revenue	**1,097,331**	1,060,758	943,279
Earnings before depreciation, amortization, and other expense (Adjusted EBITDA)	**97,597**	92,935	83,691
Earnings from continuing operations	**31,712**	31,417	23,710
per basic share *($)*	**0.36**	0.36	0.27
Gain (loss) on sale of U.S. operations, net of taxes	**–**	(8,458)	205,418
Earnings (loss) from discontinued operations	**(29,580)**	12,493	2,950
Net earnings	**2,132**	35,452	232,078
per basic share *($)*	**0.02**	0.40	2.64
per diluted share *($)*	**0.02**	0.40	2.41
AFFO (continuing operations)	**58,495**	66,722	43,587
per basic share *($)*	**0.659**	0.755	0.497
AFFO	**58,495**	65,056	50,828
per basic share *($)*	**0.659**	0.736	0.579
Cash dividends declared	**42,583**	42,422	42,125
per share *($)*	**0.480**	0.480	0.480
Financial Position *(at year end)*			
Total assets	**934,281**	988,617	1,026,947
Total non-current liabilities	**588,804**	605,353	636,798
Long-term debt	**476,404**	448,742	428,679
Long-term debt, including current portion	**536,068**	503,568	454,074
U.S./Canadian dollar average exchange rate for the year	**1.2986**	1.3248	1.2787
U.S./Canadian dollar closing exchange rate at year end	**1.2571**	1.3427	1.3840

Financial Results – The selected information provided for each of the years under the heading "Financial Results", reflects the classification of the operations in connection with the U.S. Sale Transaction and the U.S. IT Hosting business as discontinued. The U.S. senior care operations were sold in 2015, resulting in a gain, net of tax, of $205.4 million, and the U.S. IT Hosting business was sold in 2016, resulting in a loss, net of tax of $8.4 million. A comparison between the 2017 and 2016 results is provided under the heading "2017 Financial Review". The financial results for 2016, in comparison to 2015, reflect growth from all segments of our continuing operations, resulting from LTC funding enhancements, growth in our home health care operations following a significant acquisition in 2015, the expansion of our retirement living operations through the acquisition and development of retirement communities, and an increase in clients served by our management services and group purchasing operations.

Financial Position – Since the end of 2015, our total assets and non-current liabilities have declined, largely due to the "run off" of our former U.S. self-insured liabilities and related investments held by the Captive. During 2016 and 2017, our total assets declined by $38.3 million and $54.3 million, respectively. Our investments held for U.S. self-insured liabilities declined by $40.7 million (US$26.3 million) in 2016, and by $49.8 million (US$32.8 million) in 2017. Our total non-current liabilities declined by $31.4 million in 2016 and by $16.5 million in 2017, largely due to the decline in our accrual for U.S. self-insured liabilities of $53.6 million (US$36.6 million) in 2016 and $33.7 million (US$22.0 million) in 2017, partially offset by an increase in long-term debt. Our total long-term debt, including current portion, increased by $49.5 million in 2016 and by $32.5 million in 2017, reflecting the issuance of debt in connection with the acquisition and development of our retirement communities.

A comparison between the 2017 and 2016 results is provided in the discussion under the headings "2017 Financial Review" and "Liquidity and Capital Resources".

2017 SELECTED QUARTERLY INFORMATION

The following is a summary of selected quarterly financial information for the past eight quarters.

				2017				2016
(thousands of dollars unless otherwise noted)	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
Revenue	**281,398**	**273,230**	**273,845**	**268,858**	276,854	268,096	261,425	254,383
Net operating income	**35,622**	**34,729**	**33,867**	**31,604**	33,754	35,040	34,747	26,595
Net operating income margin	***12.7%***	***12.7%***	***12.4%***	***11.8%***	*12.2%*	*13.1%*	*13.3%*	*10.5%*
Adjusted EBITDA	**27,555**	**24,025**	**24,588**	**21,429**	24,246	25,525	26,647	16,517
Adjusted EBITDA margin	***9.8%***	***8.8%***	***9.0%***	***8.0%***	*8.8%*	*9.5%*	*10.2%*	*6.5%*
Earnings (loss) from continuing operations	**10,301**	**6,545**	**9,919**	**4,947**	13,250	9,955	9,695	(1,483)
Loss on sale of U.S. operations, net of taxes	–	–	–	–	(8,458)	–	–	–
Earnings (loss) from discontinued operations	**3,333**	–	**(32,913)**	–	19,848	(643)	(4,947)	(1,765)
Net earnings (loss)	**13,634**	**6,545**	**(22,994)**	**4,947**	24,640	9,312	4,748	(3,248)
AFFO (continuing operations)	**15,713**	**15,646**	**14,448**	**12,688**	13,534	20,832	20,012	12,344
per basic share *($)*	**0.178**	**0.176**	**0.162**	**0.143**	0.152	0.236	0.227	0.140
AFFO	**15,713**	**15,646**	**14,448**	**12,688**	13,366	20,300	19,155	12,235
per basic share *($)*	**0.178**	**0.176**	**0.162**	**0.143**	0.150	0.230	0.217	0.139
Maintenance Capex								
Continuing operations	**3,271**	**2,777**	**1,858**	**907**	5,419	2,825	2,835	1,040
Discontinued operations	–	–	–	–	112	280	232	110
Cash dividends declared	**10,623**	**10,642**	**10,666**	**10,652**	10,637	10,619	10,595	10,571
per share *($)*	**0.120**	**0.120**	**0.120**	**0.120**	0.120	0.120	0.120	0.120
Weighted Average Number of Shares								
Basic	**88,633**	**88,844**	**88,938**	**88,807**	88,663	88,495	88,269	88,057
Diluted	**99,916**	**100,123**	**100,244**	**100,086**	99,918	99,739	99,513	99,302
U.S./Canadian dollar average exchange rate for the period	**1.2722**	**1.2546**	**1.3449**	**1.3238**	1.3337	1.3052	1.2873	1.3731

The following is a reconciliation of “earnings (loss) from continuing operations before income taxes” to Adjusted EBITDA and “net operating income”.

				2017				2016
(thousands of dollars)	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
Earnings (loss) from continuing operations before income taxes	**13,212**	**9,874**	**12,763**	**6,715**	13,618	13,169	13,597	(1,556)
Add (Deduct):								
Depreciation and amortization	**8,170**	**7,766**	**7,911**	**7,532**	8,496	7,783	7,753	7,147
Net finance costs (income)	**6,173**	**6,385**	**3,914**	**7,182**	460	4,573	5,092	8,790
Other expense	–	–	–	–	1,672	–	205	2,136
Adjusted EBITDA	**27,555**	**24,025**	**24,588**	**21,429**	24,246	25,525	26,647	16,517
Add (Deduct):								
Administrative costs	**6,372**	**9,058**	**7,524**	**8,513**	7,843	7,843	6,458	8,407
Lease costs	**1,695**	**1,646**	**1,755**	**1,662**	1,665	1,672	1,642	1,671
Net operating income	**35,622**	**34,729**	**33,867**	**31,604**	33,754	35,040	34,747	26,595

There are a number of factors affecting the trend of our quarterly results from continuing operations.

With respect to our core operations, while year-over-year quarterly comparisons will generally remain comparable, sequential quarters can vary materially for seasonal and other trends. The significant factors that impact the results from period to period are as follows:

- Ontario long-term care funding tied to flow-through envelopes requires revenue be deferred until it is matched with the related costs for resident care in the periods in which the costs are incurred, resulting in a fluctuation in revenue and operating expenses by quarter, and they are generally at their lowest in the first quarter and at their highest in the fourth quarter;
- Ontario long-term care providers generally receive annual flow-through funding increases and case mix index adjustments effective April 1st and accommodation funding increases effective July 1st, and Alberta long-term care providers generally receive annual inflationary rate increases and acuity-based funding adjustments on April 1st, and accommodation funding increases effective July 1st;
- maintenance capex spending, which impacts our AFFO, fluctuates on a quarterly basis with the timing of projects and seasonality, and is generally at its lowest in the first quarter and its highest in the fourth quarter; and
- utility costs are generally at their highest in the first quarter and their lowest in the second and third quarters, and can vary by as much as $1.5 million to $2.0 million.

In addition, we report as separate line items, “other expense”, “fair value adjustments”, and “loss (gain) on foreign exchange”, as these are transitional in nature and would otherwise distort historical trends. Those items impacting our results are as follows:

- transaction and integration costs in connection with acquisitions, asset impairment charges, gains or losses on disposals, proxy contest costs and other costs considered transitional in nature are reported as “other expense”; as a result of acquisitions, a proxy contest, and asset impairment charges; the results from continuing operations for 2017 do not reflect any such charges as “other expense”; and the 2016 results from continuing operations included “other expense” of $4.0 million for the year ($2.1 million, $0.2 million, nil, $1.7 million in each of the quarters, respectively);
- interest rate swaps are measured at fair value through profit or loss each period as “fair value adjustments”; as a result, a net gain of $2.5 million was recorded in 2017 (loss of $0.1 million in the first quarter, gain of $1.1 million in the second quarter, a gain of $1.2 million in the third quarter; and a gain of $0.3 million in the fourth quarter); compared to a net gain of $1.0 million recorded in 2016 (loss of $0.8 million in the third quarter and a gain of $1.8 million in the fourth quarter); and
- foreign currency exchange rate fluctuations between the U.S. and Canadian dollars impact translation of our remaining U.S. net assets as a result of U.S. net proceeds and deferred consideration received in respect of the disposal or our U.S. operations in July 2015 and repatriation of funds from our Captive, our earnings from continuing operations included the following in “loss (gain) on foreign exchange”, resulting in: a net foreign exchange gain of $0.8 million in 2017 (loss of $0.4 million in the first quarter, gain of $1.5 million in the second quarter, a loss of $0.7 million in the third quarter, and a gain of $0.4 million in the fourth quarter); compared to a net foreign exchange loss of $1.2 million in 2016 (loss of $4.0 million in the first quarter, loss of $0.8 million in the second quarter, and gains of $1.3 million and $2.3 million in the third and fourth quarters, respectively).

Further details on the above can be found under the sections “Significant 2017 Events and Developments”, “Key Performance Indicators”, “Other Significant Developments” and “Update of Regulatory and Funding Changes Affecting Results”.

2017 FOURTH QUARTER FINANCIAL REVIEW

The following provides a breakdown of our consolidated statement of earnings between our Canadian and U.S. operations.

							Three months ended December 31
			2017			2016	Total
(thousands of dollars)	Canada	U.S.	Total	Canada	U.S.	Total	Change
Revenue	**279,085**	**2,313**	**281,398**	275,305	1,549	276,854	4,544
Operating expenses	**245,776**	**–**	**245,776**	243,100	–	243,100	2,676
Net operating income	**33,309**	**2,313**	**35,622**	32,205	1,549	33,754	1,868
Administrative costs	**6,462**	**(90)**	**6,372**	7,835	8	7,843	(1,471)
Lease costs	**1,695**	**–**	**1,695**	1,665	–	1,665	30
Adjusted EBITDA	**25,152**	**2,403**	**27,555**	22,705	1,541	24,246	3,309
Depreciation and amortization	**8,170**	**–**	**8,170**	8,496	–	8,496	(326)
Other expense	**–**	**–**	**–**	1,672	–	1,672	(1,672)
Earnings before net finance costs and income taxes	**16,982**	**2,403**	**19,385**	12,537	1,541	14,078	5,307
Interest expense (net of capitalized interest)	**7,342**	**–**	**7,342**	6,691	–	6,691	651
Interest revenue	**(1,091)**	**–**	**(1,091)**	(851)	(1,896)	(2,747)	1,656
Accretion	**351**	**265**	**616**	294	334	628	(12)
Fair value adjustments	**(271)**	**–**	**(271)**	(1,832)	–	(1,832)	1,561
Gain on foreign exchange	**(179)**	**(244)**	**(423)**	(592)	(1,688)	(2,280)	1,857
Net finance costs (income)	**6,152**	**21**	**6,173**	3,710	(3,250)	460	5,713
Earnings from continuing operations before income taxes	**10,830**	**2,382**	**13,212**	8,827	4,791	13,618	(406)
Income tax expense (recovery)							
Current	**1,679**	**–**	**1,679**	(603)	(1)	(604)	2,283
Deferred	**1,232**	**–**	**1,232**	(220)	1,192	972	260
Total income tax expense (recovery)	**2,911**	**–**	**2,911**	(823)	1,191	368	2,543
Earnings from continuing operations	**7,919**	**2,382**	**10,301**	9,650	3,600	13,250	(2,949)
Loss from sale of U.S. operations, net of taxes	**–**	**–**	**–**	–	(8,458)	(8,458)	8,458
Earnings (loss) from discontinued operations	**–**	**3,333**	**3,333**	–	19,848	19,848	(16,515)
Net earnings	**7,919**	**5,715**	**13,634**	9,650	14,990	24,640	(11,006)
Earnings from continuing operations	**7,919**	**2,382**	**10,301**	9,650	3,600	13,250	(2,949)
Add (Deduct) (1):							
Fair value adjustments	**(199)**	**–**	**(199)**	(1,344)	–	(1,344)	1,145
Gain on foreign exchange	**(206)**	**(244)**	**(450)**	(526)	(1,427)	(1,953)	1,503
Other expense	**–**	**–**	**–**	(1,917)	–	(1,917)	1,917
Earnings from continuing operations before separately reported items, net of taxes	**7,514**	**2,138**	**9,652**	5,863	2,173	8,036	1,616

(1) The separately reported items being added to or deducted from earnings from continuing operations are net of income taxes, and are non-GAAP measures. Refer to the discussion of non-GAAP measures.

The following provides a reconciliation of "earnings from continuing operations before income taxes" to "Adjusted EBITDA" and "net operating income".

							Three months ended December 31
			2017			2016	Total
(thousands of dollars)	Canada	U.S.	Total	Canada	U.S.	Total	Change
Earnings from continuing operations before income taxes	**10,830**	**2,382**	**13,212**	8,827	4,791	13,618	(406)
Add (Deduct):							
Depreciation and amortization	**8,170**	**–**	**8,170**	8,496	–	8,496	(326)
Net finance costs (income)	**6,152**	**21**	**6,173**	3,710	(3,250)	460	5,713
Other expense	**–**	**–**	**–**	1,672	–	1,672	(1,672)
Adjusted EBITDA	**25,152**	**2,403**	**27,555**	22,705	1,541	24,246	3,309
Add (Deduct):							
Administrative costs	**6,462**	**(90)**	**6,372**	7,835	8	7,843	(1,471)
Lease costs	**1,695**	**–**	**1,695**	1,665	–	1,665	30
Net operating income	**33,309**	**2,313**	**35,622**	32,205	1,549	33,754	1,868

The following is an analysis of the consolidated results from operations for the 2017 fourth quarter in comparison to the 2016 fourth quarter. Refer to the discussion that follows under the heading “Summary of Results of Operations by Segment” for an analysis of the revenue and net operating income by operating segment, including the components of non same-store revenue and net operating income.

Consolidated Revenue

Consolidated revenue from continuing operations grew by $4.5 million or 1.6% to $281.4 million in the 2017 fourth quarter, driven primarily by LTC funding enhancements, expansion of the retirement living operations, and higher investment income from the Captive, partially offset by the impact of favourable prior period settlement adjustments of $2.2 million received in the 2016 fourth quarter. Growth in revenue prior to these items was $6.7 million or 2.4% over 2016.

Consolidated Operating Expenses

Consolidated operating expenses from continuing operations increased by $2.6 million or 1.1% to $245.8 million in the 2017 fourth quarter. The 2016 fourth quarter results included unfavourable prior period accrual adjustments of $0.6 million with respect to our home health care operations. Prior to these items, operating expenses were higher by $3.2 million or 1.3% over 2016, driven by, increased costs of resident care and expansion of the retirement living operations. Total labour costs increased by $1.3 million over the 2016 fourth quarter, and represented 85.5% and 85.9% of operating expenses in the fourth quarters of 2017 and 2016, respectively, and as a percentage of revenue were 74.7% and 75.4%, respectively.

Consolidated Net Operating Income

Consolidated net operating income from continuing operations increased by $1.9 million or 5.5% to $35.6 million in the 2017 fourth quarter, and represented 12.7% of revenue compared to 12.2% in the same 2016 quarter. Net operating income from the Canadian operations improved by $1.1 million, and represented 11.9% of revenue this quarter compared to 11.7% in the same 2016 quarter. As noted above, the 2016 results were impacted by favourable accrual adjustments of $1.6 million. Prior to these items, net operating income from the Canadian operations improved by $2.7 million or 8.8%, reflecting LTC funding enhancements, growth of our retirement living, management and group purchasing operations, and an increased contribution from our home health care operations. Net operating income from our U.S. operations reflected higher investment income from the Captive of $0.8 million.

Administrative and Lease Costs

Administrative and lease costs from continuing operations declined by $1.4 million to $8.1 million in the 2017 fourth quarter, reflecting lower share-based compensation expense and reduced professional fees.

Consolidated Adjusted EBITDA

Consolidated Adjusted EBITDA from continuing operations improved by $3.3 million or 13.6% to $27.5 million this quarter from $24.2 million in the same 2016 quarter, representing 9.8% and 8.8% of revenue, respectively. Adjusted EBITDA from the Canadian operations contributed $2.4 million to the improvement, reflecting the increase in net operating income and lower administrative costs, as previously discussed. Prior to the favourable accrual adjustments of $1.6 million recorded in the 2016 fourth quarter, Adjusted EBITDA from the Canadian operations improved by $4.0 million, and as a percentage of revenue was 9.0% this quarter compared to 7.7% in the same 2016 quarter. Adjusted EBITDA from the U.S. operations improved by $0.9 million reflecting higher investment income and a reduction in administrative costs.

Net Finance Costs (Income)

Net finance costs increased by $5.7 million to $6.2 million this quarter, and included a reduction in interest revenue in connection with deferred consideration from the U.S. Sale Transaction of $1.9 million and unfavourable changes in the valuation of interest rate swaps of $1.5 million and the loss (gain) on foreign exchange of $1.9 million. For further information on the deferred consideration, refer to the discussion under the heading “Other Significant Development – 2015 U.S. Sale Transaction – Deferred Consideration”.

Income Taxes

The income tax provision this quarter was $2.9 million on pre-tax earnings of $13.2 million, representing an effective tax rate of 22.0%, compared to a provision of $0.4 million on pre-tax earnings of $13.6 million in the 2016 fourth quarter, representing an effective tax rate of 2.7%. The income tax provision for 2016 included the reversal of a $3.6 million provision following the successful appeal of a prior period tax reassessment (refer to the discussion under the heading "Other Significant Developments – Tax Rules and Regulations"). In addition, the effective tax rates for each period were distorted by, among other things, fair value adjustments, gains and losses on foreign exchange, and other expense items that have been separately reported. The effective tax rate on earnings from continuing operations before separately reported items was 22.9% this quarter and 28.1% in the 2016 fourth quarter, with the reduction in effective rates primarily due to the proportion of earnings between taxable and non-taxable entities.

Discontinued Operations

The earnings from discontinued operations reported in the 2016 fourth quarter included the after-tax loss on sale of the U.S. IT Hosting operations of $8.4 million.

The earnings from discontinued operations, net of tax, was $3.3 million this quarter compared to earnings of $19.8 million in the 2016 fourth quarter, excluding the above noted loss on sale for 2016. The 2017 activity related to a $3.1 million release of the Captive's reserves and a net reduction in indemnification provisions and other items in respect of the U.S. Sale Transaction. The 2016 activity related to a $12.8 million release of the Captive's reserves and a reclassification of a $9.2 million impairment loss on the IT Hosting operations to loss on sale, partially offset by a net after-tax increase in indemnification provisions and other items in respect of the U.S. Sale Transaction.

For further information on the discontinued operations, refer to *note 22* of the audited consolidated financial statements, and the discussions under the headings "Other Significant Development – 2015 U.S. Sale Transaction – Deferred Consideration" and "Other Significant Developments – 2016 Sale of U.S. IT Hosting Business".

Summary of Results of Operations by Segment

The following provides an analysis of the operating performance of each of our operating segments followed by a table summarizing our segmented "revenue", "operating expenses" and "net operating income".

LONG-TERM CARE OPERATIONS

Net operating income from our long-term care operations was $18.3 million this quarter compared to $19.6 million in the 2016 fourth quarter. Excluding the impact of favourable prior period revenue settlement adjustments of approximately $2.2 million received in the 2016 fourth quarter, net operating income improved by $0.9 million, and as a percentage of revenue was 11.6% this quarter compared to 11.2% in the same 2016 period. Revenue grew by $3.5 million, or 2.2%, of which approximately $2.3 million related to our Ontario flow-through envelopes, and was therefore directly offset by increased costs of resident care, approximately $0.2 million was from improvements in preferred accommodation, and the balance was from other funding enhancements. Operating expenses increased by $2.6 million, or 1.8%, primarily due to higher labour, supply, maintenance, and food costs, partially offset by lower property taxes and utility costs. Labour costs increased by $1.8 million and represented 82.0% of operating expenses this quarter compared to 82.3% in the same 2016 period.

RETIREMENT LIVING OPERATIONS

Net operating income from our retirement living operations improved by $0.9 million this quarter, with improvements from the lease up of the non same-store operations (West Park, Yorkton and Cedar) and the four in operation since the beginning of 2016. On a same-store basis, growth in net operating income was $0.4 million was primarily attributable to higher revenue, with the improvement in average occupancy to 93.4% this quarter from 81.3% in the 2016 fourth quarter.

HOME HEALTH CARE OPERATIONS

Net operating income from our home health care operations improved by $1.0 million or 10.0% to $11.0 million this quarter, and represented 10.1% of revenue compared to 9.2% in the 2016 fourth quarter. Excluding the impact of unfavourable prior period accrual adjustments of approximately $0.6 million recorded in the 2016 fourth quarter, net operating income improved by $0.4 million, and as a percentage of revenue was 10.1% this quarter compared to 9.7%. This improvement was largely attributable to higher revenue due to a shift in the mix of services provided. Overall volumes were down by 1% in the quarter, with improvements in our Ontario volumes offset by declines in other provinces. Total labour costs declined by $1.0 million and represented 91.9% of operating expenses in the 2017 fourth quarter compared to 92.3% in the same 2016 quarter.

OTHER CANADIAN OPERATIONS

Net operating income from our management and group purchasing operations increased by $0.5 million this quarter, and represented 57.8% of revenue compared to 51.9% in the 2016 fourth quarter, largely due to growth in group purchasing clients, with the Extendicare Assist operations unchanged from the same 2016 quarter, having benefited from increased consulting revenue this quarter.

U.S. OPERATIONS

Net operating income of the Captive improved by $0.8 million this quarter due to higher investment income.

The following table summarizes our segmented "revenue", "operating expenses" and "net operating income".

Three months ended December 31 *(thousands of dollars)*	**Long-term Care**	**Retirement Living**	**Home Health Care**	**Other Canadian Operations**	**Corporate Canada**	**Total Canada**	**Total U.S.**	**Total**
2017 – Same-store								
Revenue	**158,694**	**4,103**	**109,141**	**5,149**	**3**	**277,090**	**2,313**	**279,403**
Operating expenses	**140,349**	**2,892**	**98,160**	**2,175**	**−**	**243,576**	**−**	**243,576**
Net operating income	**18,345**	**1,211**	**10,981**	**2,974**	**3**	**33,514**	**2,313**	**35,827**
Net operating income margin (%)	***11.6%***	***29.5%***	***10.1%***	***57.8%***	***100.0%***	***12.1%***	***100.0%***	***12.8%***
2017 – Non Same-store								
Revenue	**−**	**1,995**	**−**	**−**	**−**	**1,995**	**−**	**1,995**
Operating expenses	**−**	**2,200**	**−**	**−**	**−**	**2,200**	**−**	**2,200**
Net operating loss	**−**	**(205)**	**−**	**−**	**−**	**(205)**	**−**	**(205)**
2017 – Total								
Revenue	**158,694**	**6,098**	**109,141**	**5,149**	**3**	**279,085**	**2,313**	**281,398**
Operating expenses	**140,349**	**5,092**	**98,160**	**2,175**	**−**	**245,776**	**−**	**245,776**
Net operating income	**18,345**	**1,006**	**10,981**	**2,974**	**3**	**33,309**	**2,313**	**35,622**
Net operating income margin (%)	***11.6%***	***16.5%***	***10.1%***	***57.8%***	***100.0%***	***11.9%***	***100.0%***	***12.7%***
2016 – Same-store								
Revenue	157,425	3,734	108,672	4,765	3	274,599	1,549	276,148
Operating expenses	137,809	2,902	98,688	2,293	−	241,692	−	241,692
Net operating income	19,616	832	9,984	2,472	3	32,907	1,549	34,456
Net operating income margin (%)	*12.5%*	*22.3%*	*9.2%*	*51.9%*	*100.0%*	*12.0%*	*100.0%*	*12.5%*
2016 – Non Same-store								
Revenue	−	706	−	−	−	706	−	706
Operating expenses	−	1,408	−	−	−	1,408	−	1,408
Net operating loss	−	(702)	−	−	−	(702)	−	(702)
2016 – Total								
Revenue	157,425	4,440	108,672	4,765	3	275,305	1,549	276,854
Operating expenses	137,809	4,310	98,688	2,293	−	243,100	−	243,100
Net operating income	19,616	130	9,984	2,472	3	32,205	1,549	33,754
Net operating income margin (%)	*12.5%*	*2.9%*	*9.2%*	*51.9%*	*100.0%*	*11.7%*	*100.0%*	*12.2%*
Change in Total								
Revenue	1,269	1,658	469	384	−	3,780	764	4,544
Operating expenses	2,540	782	(528)	(118)	−	2,676	−	2,676
Net operating income	(1,271)	876	997	502	−0	1,104	764	1,868

2017 FINANCIAL REVIEW

The following provides a breakdown of our consolidated statement of earnings between our Canadian and U.S. operations.

							Years ended December 31
			2017			**2016**	**Total**
(thousands of dollars)	**Canada**	**U.S.**	**Total**	**Canada**	**U.S.**	**Total**	**Change**
Revenue	**1,092,082**	**5,249**	**1,097,331**	1,057,063	3,695	1,060,758	36,573
Operating expenses	**961,509**	**–**	**961,509**	930,622	–	930,622	30,887
Net operating income	**130,573**	**5,249**	**135,822**	126,441	3,695	130,136	5,686
Administrative costs	**30,333**	**1,134**	**31,467**	28,662	1,889	30,551	916
Lease costs	**6,758**	**–**	**6,758**	6,650	–	6,650	108
Adjusted EBITDA	**93,482**	**4,115**	**97,597**	91,129	1,806	92,935	4,662
Depreciation and amortization	**31,379**	**–**	**31,379**	31,179	–	31,179	200
Other expense	**–**	**–**	**–**	4,013	–	4,013	(4,013)
Earnings before net finance costs and income taxes	**62,103**	**4,115**	**66,218**	55,937	1,806	57,743	8,475
Interest expense (net of capitalized interest)	**28,082**	**–**	**28,082**	27,039	–	27,039	1,043
Interest revenue	**(3,695)**	**(207)**	**(3,902)**	(3,276)	(7,562)	(10,838)	6,936
Accretion	**1,529**	**1,283**	**2,812**	1,176	1,325	2,501	311
Fair value adjustments	**(2,474)**	**–**	**(2,474)**	(985)	–	(985)	(1,489)
Loss (gain) on foreign exchange	**666**	**(1,530)**	**(864)**	753	445	1,198	(2,062)
Net finance costs (income)	**24,108**	**(454)**	**23,654**	24,707	(5,792)	18,915	4,739
Earnings from continuing operations before income taxes	**37,995**	**4,569**	**42,564**	31,230	7,598	38,828	3,736
Income tax expense (recovery)							
Current	**10,149**	**–**	**10,149**	6,818	(1,017)	5,801	4,348
Deferred	**603**	**100**	**703**	(2,094)	3,704	1,610	(907)
Total income tax expense	**10,752**	**100**	**10,852**	4,724	2,687	7,411	3,441
Earnings from continuing operations	**27,243**	**4,469**	**31,712**	26,506	4,911	31,417	295
Loss from sale of U.S. operations, net of taxes	–	–	–	–	(8,458)	(8,458)	8,458
Earnings (loss) from discontinued operations	**–**	**(29,580)**	**(29,580)**	–	12,493	12,493	(42,073)
Net earnings (loss)	**27,243**	**(25,111)**	**2,132**	26,506	8,946	35,452	(33,320)
Earnings from continuing operations	**27,243**	**4,469**	**31,712**	26,506	4,911	31,417	295
Add (Deduct) [1]**:**							
Fair value adjustments	**(1,813)**	**–**	**(1,813)**	(722)	–	(722)	(1,091)
Loss (gain) on foreign exchange	**805**	**(1,512)**	**(707)**	267	141	408	(1,115)
Other expense	**–**	**–**	**–**	(196)	–	(196)	196
Earnings from continuing operations before separately reported items, net of taxes	**26,235**	**2,957**	**29,192**	25,855	5,052	30,907	(1,715)

(1) The separately reported items being added to or deducted from earnings from continuing operations are net of income taxes, and are non-GAAP measures. Refer to the discussion of non-GAAP measures.

The following provides a reconciliation of “earnings from continuing operations before income taxes” to “Adjusted EBITDA” and “net operating income”.

							Years ended December 31
			2017			**2016**	**Total**
(thousands of dollars)	**Canada**	**U.S.**	**Total**	**Canada**	**U.S.**	**Total**	**Change**
Earnings from continuing operations before income taxes	**37,995**	**4,569**	**42,564**	31,230	7,598	38,828	3,736
Add (Deduct):							
Depreciation and amortization	**31,379**	**–**	**31,379**	31,179	–	31,179	200
Net finance costs (income)	**24,108**	**(454)**	**23,654**	24,707	(5,792)	18,915	4,739
Other expense	**–**	**–**	**–**	4,013	–	4,013	(4,013)
Adjusted EBITDA	**93,482**	**4,115**	**97,597**	91,129	1,806	92,935	4,662
Add (Deduct):							
Administrative costs	**30,333**	**1,134**	**31,467**	28,662	1,889	30,551	916
Lease costs	**6,758**	**–**	**6,758**	6,650	–	6,650	108
Net operating income	**130,573**	**5,249**	**135,822**	126,441	3,695	130,136	5,686

The following is an analysis of the consolidated results from operations for 2017 in comparison to 2016. Refer to the discussion that follows under the heading "Summary of Results of Operations by Segment" for an analysis of the revenue and net operating income by operating segment, including the components of non same-store revenue and net operating income.

Consolidated Revenue

Consolidated revenue from continuing operations grew by $36.6 million or 3.4% to $1,097.3 million in 2017, driven primarily by a 4.1% increase in home health care business volumes, increased government funding for home health care to support mandated wage increases for personal support workers (PSWs) of approximately $2.1 million, LTC funding enhancements (including favourable prior year settlement adjustments of $0.8 million in 2017 and $1.2 million in 2016), expansion of the retirement living operations, and a $1.6 million increase in investment income from the Captive, partially offset by one less day this year.

Consolidated Operating Expenses

Consolidated operating expenses from continuing operations increased by $30.9 million or 3.3% to $961.5 million in 2017, primarily due to growth in the home health care volumes, the mandatory PSW wage increases, increased severance costs in our home health care operations of approximately $0.8 million largely in connection with productivity initiatives, increased costs of resident care, expansion of the retirement operations, and the impact of favourable labour cost accrual adjustments of $1.0 million recorded in 2016, partially offset by one less day this year. The majority of our operating expenses are labour related, which increased by $26.2 million over 2016, and represented 86.6% of operating expenses in each of 2017 and 2016, and as a percentage of revenue were 75.9% and 76.0%, respectively.

Consolidated Net Operating Income

Consolidated net operating income from continuing operations improved by $5.7 million or 4.4% to $135.8 million in 2017, and as a percentage of revenue was 12.4% in 2017 compared to 12.3% in 2016. Net operating income from the Canadian operations improved by $4.1 million, and represented 12.0% of revenue in each of 2017 and 2016. Prior to the $2.2 million of favourable prior year revenue settlements and operating expense accrual adjustments recorded in 2016, as noted above, net operating income from the Canadian operations improved by $6.3 million, reflecting growth in our home health care business volumes and retirement living operations, partially offset by increased costs of resident care, and one less day this year. Net operating income from our U.S. operations reflected higher investment income from the Captive of $1.6 million.

Administrative and Lease Costs

Administrative costs from continuing operations increased by $0.9 million to $31.5 million in 2017, reflecting an increase from our Canadian operations of $1.7 million, partially offset by reduced costs to support the remaining U.S. operations. The higher costs of our Canadian operations included a one-time executive compensation charge of $2.0 million recorded in the 2017 third quarter. As a percentage of revenue, the Canadian operations administrative costs represented 2.8% of revenue in 2017 compared to 2.7% in 2016.

Lease costs increased by $0.1 million this year, primarily due to lease termination costs.

Consolidated Adjusted EBITDA

Consolidated Adjusted EBITDA from continuing operations improved by $4.7 million or 5.0% to $97.6 million in 2017, and represented 8.9% of revenue compared to 8.8% in 2016. Adjusted EBITDA from the Canadian operations improved by $2.3 million to $93.5 million this year, reflecting growth from net operating income offset by higher administrative and lease costs, as previously discussed, and as a percentage of revenue was unchanged at 8.6%. Prior to the one-time executive compensation charge of $2.0 million recorded this year and the $2.2 million of favourable prior year adjustments recorded in 2016, Adjusted EBITDA from the Canadian operations as a percentage of revenue would have been 8.7% this year compared to 8.4% in 2016. Adjusted EBITDA from the U.S. operations improved by $2.4 million due to the increase in investment income and reduction in administrative costs.

Depreciation and Amortization

Depreciation and amortization costs increased by $0.2 million to $31.4 million this year, largely due to acquisitions and completed development projects.

Other Expense

The Company has not recorded any amounts in other expense in 2017. In 2016, the other expense of $4.0 million related to proxy contest costs, including advisory and professional fees, of $1.9 million, impairment of goodwill for certain properties of $1.7 million, and the balance to integration and acquisitions costs.

Net Finance Costs (Income)

Net finance costs increased by $4.7 million to $23.6 million this year, and included favourable changes of $3.6 million in the valuation of interest rate swaps and loss (gain) on foreign exchange. Excluding these items, net finance costs increased by $8.3 million primarily due to a reduction in interest revenue in connection with deferred consideration from the U.S. Sale Transaction of $7.4 million, and increased interest expense due to higher debt levels.

Income Taxes

The income tax provision for 2017 was $10.8 million on pre-tax earnings of $42.6 million, representing an effective tax rate of 25.5%, compared to a provision of $7.4 million on pre-tax earnings of $38.8 million in 2016, representing and effective tax rate of 19.1%. The income tax provision for 2016 included the reversal of a $3.6 million provision following the successful appeal of a prior period tax reassessment (refer to the discussion under the heading "Other Significant Developments – Tax Rules and Regulations"). In addition, the effective tax rates for each period were distorted by, among other things, fair value adjustments, gains and losses on foreign exchange, and other expense items that have been separately reported. The effective tax rate on earnings from continuing operations before separately reported items was 25.6% this year and 28.2% in 2016, with the reduction in effective rates primarily due to the proportion of earnings between taxable and non-taxable entities.

Discontinued Operations

The earnings from discontinued operations reported in 2016 included the after-tax loss on sale of the U.S. IT Hosting operations of $8.4 million.

The loss from discontinued operations, net of tax, was $29.6 million this year compared to earnings of $12.5 million in 2016, excluding the above noted loss on sale for 2016. The 2017 activity related to the U.S. Sale Transaction that included the write-off of deferred consideration of $37.5 million ($32.2 million after tax), and a net increase in indemnification provisions and other items of $4.8 million ($3.1 million after tax), partially offset by a $5.7 million release of the Captive's reserves. The 2016 activity related to a $16.8 million release of the Captive's reserves, partially offset by a net after-tax increase in indemnification provisions and other items in respect of the U.S. Sale Transaction, and a net loss from the operations of the disposed U.S. IT Hosting business prior to its sale, totalling $11.5 million, partially offset by a $4.0 million release of the Captive's reserves and a net decrease in indemnification provisions in respect of the U.S. Sale Transaction.

For further information on the discontinued operations, refer to *note 22* of the audited consolidated financial statements, and the discussions under the headings "Other Significant Developments – 2015 U.S. Sale Transaction – Deferred Consideration" and "Other Significant Developments – 2016 Sale of U.S. IT Hosting Business".

Summary of Results of Operations by Segment

The following table summarizes our segmented "revenue", "operating expenses" and "net operating income", followed by an analysis of the operating performance of each of our operating segments.

Years ended December 31 *(thousands of dollars)*	**Long-term Care**	**Retirement Living**	**Home Health Care**	**Other Canadian Operations**	**Corporate Canada**	**Total Canada**	**Total U.S.**	**Total**
2017 – Same-store								
Revenue	**616,887**	**15,186**	**435,718**	**18,789**	**15**	**1,086,595**	**5,249**	**1,091,844**
Operating expenses	**542,965**	**11,450**	**391,867**	**8,387**	**–**	**954,669**	**–**	**954,669**
Net operating income	**73,922**	**3,736**	**43,851**	**10,402**	**15**	**131,926**	**5,249**	**137,175**
Net operating income margin (%)	***12.0%***	***24.6%***	***10.1%***	***55.4%***	***100.0%***	***12.1%***	***100.0%***	***12.6%***
2017 – Non Same-store								
Revenue	**–**	**5,487**	**–**	**–**	**–**	**5,487**	**–**	**5,487**
Operating expenses	**–**	**6,840**	**–**	**–**	**–**	**6,840**	**–**	**6,840**
Net operating loss	**–**	**(1,353)**	**–**	**–**	**–**	**(1,353)**	**–**	**(1,353)**
2017 – Total								
Revenue	**616,887**	**20,673**	**435,718**	**18,789**	**15**	**1,092,082**	**5,249**	**1,097,331**
Operating expenses	**542,965**	**18,290**	**391,867**	**8,387**	**–**	**961,509**	**–**	**961,509**
Net operating income	**73,922**	**2,383**	**43,851**	**10,402**	**15**	**130,573**	**5,249**	**135,822**
Net operating income margin (%)	***12.0%***	***11.5%***	***10.1%***	***55.4%***	***100.0%***	***12.0%***	***100.0%***	***12.4%***
2016 – Same-store								
Revenue	608,618	13,844	414,406	18,518	47	1,055,433	3,695	1,059,128
Operating expenses	532,999	10,829	374,191	8,605	–	926,624	–	926,624
Net operating income	75,619	3,015	40,215	9,913	47	128,809	3,695	132,504
Net operating income margin (%)	*12.4%*	*21.8%*	*9.7%*	*53.5%*	*100.0%*	*12.2%*	*100.0%*	*12.5%*
2016 – Non Same-store								
Revenue	–	1,630	–	–	–	1,630	–	1,630
Operating expenses	–	3,998	–	–	–	3,998	–	3,998
Net operating loss	–	(2,368)	–	–	–	(2,368)	–	(2,368)
2016 – Total								
Revenue	608,618	15,474	414,406	18,518	47	1,057,063	3,695	1,060,758
Operating expenses	532,999	14,827	374,191	8,605	–	930,622	–	930,622
Net operating income	75,619	647	40,215	9,913	47	126,441	3,695	130,136
Net operating income margin (%)	*12.4%*	*4.2%*	*9.7%*	*53.5%*	*100.0%*	*12.0%*	*100.0%*	*12.3%*
Change in Total								
Revenue	8,269	5,199	21,312	271	(32)	35,019	1,554	36,573
Operating expenses	9,966	3,463	17,676	(218)	–	30,887	–	30,887
Net operating income	(1,697)	1,736	3,636	489	(32)	4,132	1,554	5,686

LONG-TERM CARE OPERATIONS

Net operating income from our long-term care operations declined by $1.7 million or 2.2% to $73.9 million in 2017, and represented 12.0% of revenue compared to 12.4% in 2016. Both years were impacted by favourable prior year adjustments of approximately $0.8 million in 2017 and $2.2 million in 2016. Excluding these items, net operating income was lower by approximately $0.3 million, primarily due to one less day this year, and funding enhancements offset by higher costs of resident care. Revenue growth of $8.3 million, or 1.4%, included approximately $6.3 million related to our Ontario flow-through envelopes, prior year funding received in the 2017 first quarter of $0.8 million, improvements in preferred accommodation of approximately $0.7 million, and other funding enhancements, partially offset by prior year settlement adjustments received in the 2016 fourth quarter of $1.2 million, a $1.3 million reduction in funding tied to lower property taxes, and the impact of one less day this year. Operating expenses increased by $10.0 million, or 1.9%, primarily due to higher labour, supply, maintenance, and food costs, as well as the impact of favourable labour cost accrual adjustments of $1.0 million recorded in the 2016 third quarter, partially offset by lower property tax assessments of $1.5 million, lower utility costs of $0.4 million, and one less day this year. Labour costs increased by $7.9 million this year, and as a percentage of operating expense, were 83.2% this year compared to 83.3% in 2016.

RETIREMENT LIVING OPERATIONS

Net operating income from our retirement living operations improved by $1.7 million to $2.4 million in 2017. On a same-store basis, net operating income from four retirement communities (Empire, Harvest, Stonebridge and Riverbend) improved by $0.7 million, reflecting an increase in revenue of $1.3 million, partially offset by higher operating costs that included increased property taxes of $0.2 million. The average occupancy of the same-store retirement communities increased to 86.5% this year from 75.3% in 2016. Net operating income from our three stabilized retirement communities (Empire, Stonebridge and Riverbend) improved by $0.7 million this largely due to an increase in average occupancy to 90.8% from 81.5% in 2016.

HOME HEALTH CARE OPERATIONS

Net operating income from our home health care operations improved by $3.6 million or 9.0% to $43.8 million in 2017, and represented 10.1% of revenue compared to 9.7% in 2016. This improvement was due to a 4.1% growth in daily hours of service to 31,032 this year from 29,807 in 2016, partially offset by one less day this year and increased labour costs. Revenue growth of $21.3 million, or 5.1%, included approximately $2.1 million of funding enhancements from the Ontario government to compensate operators for mandatory PSW wage increases. Operating expenses grew by $17.7 million primarily due to higher labour costs of $16.3 million, and included higher severance costs this year of approximately $0.8 million largely in connection with our productivity initiatives, in addition to the impact of mandated benefit cost increases in the western provinces and by increased WSIB charges. Management is in dialogue with the respective health care authorities regarding enhanced funding to compensate for increased costs; however, the outcome is uncertain at this time. Labour costs represented 92.5% of operating expenses in each of 2017 and 2016. Management initiatives continue with a specific focus to improve efficiency and reduce costs in our core home health care operations.

OTHER CANADIAN OPERATIONS

Net operating income from our management and group purchasing operations improved by $0.5 million to $10.4 million in 2017, and represented 55.4% of revenue this year compared to 53.5% in 2016. Growth in group purchasing clients offset the impact of a net decline in the number of managed clients of Extendicare Assist. As at December 31, 2017, Extendicare Assist managed three fewer centres than as at the end of 2016, due to the sale of centres to new operators, partially offset by new contracts secured. Extendicare Assist has subsequently secured contracts to manage three additional centres (416 beds) that are expected to transition in March.

U.S. OPERATIONS

Net operating income of the Captive increased by $1.6 million this year due to higher investment income.

ADJUSTED FUNDS FROM OPERATIONS

The following table provides a reconciliation of our "earnings from continuing operations" to FFO and AFFO. A reconciliation of our "net cash from operating activities" to AFFO is also provided under the heading "Reconciliation of Net Cash from Operating Activities to AFFO".

	Three months ended December 31			Twelve months ended December 31		
(thousands of dollars unless otherwise noted)	**2017**	**2016**	**Change**	**2017**	**2016**	**Change**
Earnings from continuing operations	**10,301**	13,250	(2,949)	**31,712**	31,417	295
Add (Deduct):						
Depreciation and amortization	**8,170**	8,496	(326)	**31,379**	31,179	200
Depreciation for FFEC (maintenance capex) (1)	**(1,914)**	(1,882)	(32)	**(7,495)**	(7,567)	72
Other expense	**–**	1,672	(1,672)	**–**	4,013	(4,013)
Fair value adjustments	**(271)**	(1,832)	1,561	**(2,474)**	(985)	(1,489)
Loss (gain) on foreign exchange	**(423)**	(2,280)	1,857	**(864)**	1,198	(2,062)
Current income tax expense (recovery) on other expense, fair value adjustments, and gain/loss on foreign exchange (2)	**(161)**	(3,588)	3,427	**–**	(4,248)	4,248
Deferred income tax expense	**1,232**	972	260	**703**	1,610	(907)
FFO (continuing operations)	**16,934**	14,808	2,126	**52,961**	56,617	(3,656)
Amortization of financing costs	**417**	428	(11)	**1,728**	1,592	136
Accretion costs	**616**	628	(12)	**2,812**	2,501	311
Non-cash share-based compensation	**289**	292	(3)	**1,496**	941	555
Principal portion of government capital funding	**1,232**	1,180	52	**4,928**	5,648	(720)
Income support (retirement acquisitions)	**–**	1,358	(1,358)	**66**	6,263	(6,197)
Amounts offset through investments held for self-insured liabilities (3)	**(2,418)**	(1,623)	(795)	**(4,178)**	(2,288)	(1,890)
Additional maintenance capex (1)	**(1,357)**	(3,537)	2,180	**(1,318)**	(4,552)	3,234
AFFO (continuing operations)	**15,713**	13,534	2,179	**58,495**	66,722	(8,227)
Discontinued operations	**–**	(168)	168	**–**	(1,666)	1,666
AFFO	**15,713**	13,366	2,347	**58,495**	65,056	(6,561)
Per Basic Share *($)*						
FFO (continuing operations)	**0.191**	0.167	0.024	**0.596**	0.641	(0.045)
FFO	**0.191**	0.167	0.024	**0.596**	0.618	(0.022)
AFFO (continuing operations)	**0.178**	0.152	0.026	**0.659**	0.755	(0.096)
AFFO	**0.178**	0.150	0.028	**0.659**	0.736	(0.077)
Per Diluted Share *($)*						
FFO (continuing operations)	**0.191**	0.165	0.026	**0.596**	0.638	(0.042)
FFO	**0.191**	0.167	0.024	**0.596**	0.618	(0.022)
AFFO (continuing operations)	**0.171**	0.149	0.022	**0.640**	0.724	(0.084)
AFFO	**0.171**	0.147	0.024	**0.640**	0.707	(0.067)
Dividends *($)*						
Declared	**10,623**	10,637	(14)	**42,583**	42,422	161
Declared per share *($)*	**0.120**	0.120	–	**0.480**	0.480	–
Weighted Average Number of Shares *(thousands)*						
Basic	**88,633**	88,663		**88,805**	88,372	
Diluted	**99,916**	99,918		**100,088**	99,624	

(1) The aggregate of these two line items represents our total actual maintenance capex incurred in the period. An amount equivalent to our depreciation for FFEC, or furniture, fixtures, equipment and computers, is deducted in determining FFO, and the difference in total maintenance capex incurred is adjusted for in determining AFFO.

(2) Represents current income tax with respect to items that are excluded from the computation of FFO and AFFO from continuing operations, such as fair value adjustments, gains or losses on foreign exchange, other expense, and provisions for prior period tax reassessments.

(3) Represents AFFO of the Captive that decreases/(increases) the Captive's investments held for self-insured liabilities not impacting the Company's reported cash and short-term investments.

AFFO 2017 Fourth Quarter Financial Review

AFFO improved by $2.3 million to $15.7 million ($0.178 per basic share) in the 2017 fourth quarter from $13.4 million ($0.150 per basic share) in the same 2016 period. AFFO from continuing operations contributed $2.2 million of the improvement reflecting an improvement in Adjusted EBITDA, net of a reduction in income support on acquired retirement communities, lower current income taxes, and a reduction in maintenance capex, partially offset by higher net interest expense of $2.3 million. The increase in net interest expense included lower interest revenue in connection with deferred consideration from the U.S. Sale Transaction of $1.9 million. A discussion of the factors impacting Adjusted EBITDA from continuing operations can be found under the heading "2017 Fourth Quarter Financial Review".

Maintenance capex from continuing operations was $3.3 million this quarter, compared to $5.4 million in the 2016 fourth quarter, representing 1.2% and 2.0% of revenue from continuing operations, respectively.

The following provides a breakdown of AFFO and maintenance capex between our Canadian and U.S. operations.

	Three months ended December 31						
			2017			**2016**	**Total**
(thousands of dollars unless otherwise noted)	**Canada**	**U.S.**	**Total**	**Canada**	**U.S.**	**Total**	**Change**
AFFO (continuing operations)	**15,728**	**(15)**	**15,713**	11,719	1,815	13,534	2,179
Discontinued operations	–	–	–	–	(168)	(168)	168
AFFO	**15,728**	**(15)**	**15,713**	11,719	1,647	13,366	2,347
Maintenance capex (continuing operations)	**3,271**	–	**3,271**	5,419	–	5,419	(2,148)
Discontinued operations	–	–	–	–	112	112	(112)
Maintenance capex	**3,271**	–	**3,271**	5,419	112	5,531	(2,260)
Average U.S./Canadian dollar exchange rate			**1.2722**			1.3337	

AFFO 2017 Financial Review

The following provides a breakdown of AFFO and maintenance capex between our Canadian and U.S. operations.

	Twelve months ended December 31						
			2017			**2016**	**Total**
(thousands of dollars unless otherwise noted)	**Canada**	**U.S.**	**Total**	**Canada**	**U.S.**	**Total**	**Change**
AFFO (continuing operations)	**58,351**	**144**	**58,495**	58,625	8,097	66,722	(8,227)
Discontinued operations	–	–	–	–	(1,666)	(1,666)	1,666
AFFO	**58,351**	**144**	**58,495**	58,625	6,431	65,056	(6,561)
Maintenance capex (continuing operations)	**8,813**	–	**8,813**	12,119	–	12,119	(3,306)
Discontinued operations	–	–	–	–	734	734	(734)
Maintenance capex	**8,813**	–	**8,813**	12,119	734	12,853	(4,040)
Average U.S./Canadian dollar exchange rate			**1.2986**			1.3248	

AFFO declined by $6.5 million to $58.5 million ($0.659 per basic share) in 2017 from $65.0 million ($0.736 per basic share) in 2016, representing a decline in AFFO from continuing operations, partially offset by a reduction in losses from discontinued operations. The decline in AFFO from continuing operations of $8.2 million was primarily attributable to higher net interest expense of $7.8 million, a reduction in the contribution of Adjusted EBITDA net of income support on acquired retirement communities, and lower government capital funding, partially offset by lower maintenance capex. The increase in net interest expense included lower interest revenue in connection with deferred consideration from the U.S. Sale Transaction of $7.4 million. A discussion of the factors impacting Adjusted EBITDA from continuing operations can be found under the heading "2017 Financial Review".

Maintenance capex from continuing operations was $8.8 million this year, compared to $12.1 million in 2016, representing 0.8% and 1.1% of revenue from continuing operations. These costs fluctuate on a quarterly and annual basis with the timing of projects and seasonality. Management monitors and prioritizes the capital expenditure requirements of its properties throughout the year, taking into account the urgency and necessity of the expenditure. In 2018, we are expecting to spend in the range of $9 million to $10 million in maintenance capex, and in the range of $50 million to $55 million in growth capex related primarily to the retirement development projects.

Reconciliation of Net Cash from Operating Activities to AFFO

The following table provides a reconciliation of our "net cash from operating activities" to AFFO, which includes the impact of discontinued operations.

	Three months ended December 31		Twelve months ended December 31	
(thousands of dollars)	**2017**	**2016**	**2017**	**2016**
Net cash from operating activities	**10,581**	16,998	**47,160**	311
Add (Deduct):				
Net change in operating assets and liabilities, including interest, taxes and payments for U.S. self-insured liabilities	**11,042**	4,341	**20,802**	63,717
Current income tax on items excluded from AFFO (1)	**(1,391)**	(3,357)	**(1,230)**	4,258
Depreciation for FFEC (maintenance capex) (2)	**(1,914)**	(1,885)	**(7,495)**	(8,658)
Additional maintenance capex (2)	**(1,357)**	(3,646)	**(1,318)**	(4,195)
Principal portion of government capital funding	**1,232**	1,180	**4,928**	5,648
Income support (retirement acquisitions)	**–**	1,358	**66**	6,263
Amounts offset through investments held for self-insured liabilities (3)	**(2,418)**	(1,623)	**(4,178)**	(2,288)
Other	**(62)**	–	**(240)**	–
AFFO	**15,713**	13,366	**58,495**	65,056

(1) Represents current income tax with respect to items that are excluded from the computation of AFFO, such as the gain on sale of the U.S. operations, the provision for U.S. government investigations, fair value adjustments, gains or losses on foreign exchange, other expense, and provisions for prior period tax reassessments.

(2) These two line items combined represent the total of our maintenance capex incurred in the period. An amount equivalent to our depreciation for FFEC, or furniture, fixtures, equipment and computers, is deducted in determining FFO, and the difference in total maintenance capex incurred is adjusted for in determining AFFO.

(3) Represents AFFO of the Captive that decreases/(increases) its investments held for self-insured liabilities not impacting the Company's reported cash and short-term investments.

OTHER SIGNIFICANT DEVELOPMENTS

The discussion under the heading "Significant 2017 Events and Developments" summarizes our current activities related to the continued expansion into the retirement sector. This section provides a summary of other developments that have impacted the financial results or operations of Extendicare for 2017 in comparison to 2016.

Expansion of Alberta Long-term Care Centre

In February 2018, the Company completed a 24-bed addition to its Extendicare Eaux Claires long-term care centre in Edmonton, Alberta, at an estimated cost of $3.5 million. The initial 180-bed centre was built in 2011 with a design allowing for expansion. We anticipate the additional beds will achieve stabilized occupancy in the second quarter of 2018, and provide incremental net operating income of approximately $0.6 million annually.

2015 U.S. Sale Transaction – Deferred Consideration

As part of the proceeds from the U.S. Sale Transaction, the Company was entitled to receive an ongoing cash stream for a period of 15 years relating to certain U.S. skilled nursing centres that were leased prior to the closing (the "Leased Centres"). The present value ascribed to these proceeds was reflected as deferred consideration and was recorded at amortized cost using the effective interest method. During the 2017 second quarter, the Company was notified of the potential for an event of default by the operator of the Leased Centres, and subsequently received notice that the operator of the Leased Centres had failed to make its required minimum lease payments. As a result of this event and related discussions, the Company does not expect to receive any further amounts and has written off the balance of the deferred consideration of US$27.9 million, resulting in a charge of $37.5 million in the 2017 second quarter. For further details, refer to *note 22* of the audited consolidated financial statements.

2016 Sale of U.S. IT Hosting Business

On December 22, 2016, the Company completed the sale of substantially all of the assets used in the operation of its U.S. IT Hosting business for cash proceeds of $11.5 million (US$8.5 million), prior to working capital adjustments and transaction costs. Net proceeds from the sale, after working capital adjustments and transaction costs, were $9.5 million (US$7.1 million), resulting in a pre-tax loss on sale of $8.6 million (after-tax loss of $8.4 million). During 2016, an impairment assessment of the U.S. IT Hosting operations using the expected proceeds resulted in a pre-tax impairment loss of $9.2 million (US$7.1 million) in the aggregate, booked in the second and third quarters of 2016. This impairment loss

was reclassified to the loss on sale following the final sale in the 2016 fourth quarter. For further details, refer to *note 22* of the audited consolidated financial statements.

Other Financing Activity

In February 2017, the Company renewed Canadian Mortgage and Housing Corporation (CMHC) mortgages totalling $16.5 million on two of its Ontario long-term care (LTC) centres for a term of 15 years to February 2032, at a fixed rate of 3.35%.

In March 2017, the Company renewed its existing $5.8 million CMHC mortgage on a Manitoba LTC centre for a term of almost 10 years to November 2026, at a fixed rate of 3.04%.

In May 2017, the Company secured a $30.0 million term loan with the Canadian Imperial Bank of Commerce (the "CIBC Term Loan") upon maturity of $3.6 million of the existing mortgages on nine Alberta LTC centres. The CIBC Term Loan bears an interest rate based on a variable 30-day banker's acceptance rate plus 1.8% for a term of five years to May 2022, with principal and interest payable in monthly installments based on a 20-year amortization. The maximum borrowing base under the CIBC Term Loan will be determined annually based on the aggregate of the updated lending values established for each property. The Company entered into an interest rate swap contract to lock in the rate at 3.27% for the full term. The interest rate swap contract is measured at fair value through profit or loss.

In November 2017, the Company arranged for a demand credit facility in the amount of $65.0 million (the "ParaMed Credit Facility") that is secured by the assets of our home health care business, and is available for general corporate purposes of the Company. The ParaMed Credit Facility has no financial covenants, but does contain normal and customary terms. The full $65.0 million was available and unutilized as at December 31, 2017.

Extendicare has a demand credit facility in the amount of $47.3 million with the Royal Bank of Canada (the "RBC Credit Facility") that is secured by 13 Class C LTC centres in Ontario and is guaranteed by certain Canadian subsidiaries of Extendicare. As at December 31, 2017, Extendicare had letters of credit totalling approximately $43.8 million issued under the RBC Credit Facility, of which $39.9 million secure our defined benefit pension plan obligations and the balance were issued in connection with obligations relating to recently acquired centres and those centres under development. The letter of credit to secure the pension plan obligations renews annually in May based on an actuarial valuation. The RBC Credit Facility has no financial covenants, but does contain normal and customary terms including annual re-appraisals of the centres that could limit the maximum amount available.

Tax Reassessment

Following a successful notice of objection to appeal a 2015 reassessment by the Canada Revenue Agency (CRA), the Company reversed a $3.6 million tax provision, reflected as a current income tax recovery, in the 2016 fourth quarter. Given the nature of this item, including the fact that it related to prior periods, it was excluded from the determination of AFFO and "earnings (loss) from continuing operations before separately reported items, net of taxes" for the year ended December 31, 2016.

UPDATE OF REGULATORY AND FUNDING CHANGES AFFECTING RESULTS

In Canada, provincial legislation and regulations closely control all aspects of operation and funding of long-term care centres and publicly funded home health care services, including the fee structure, subsidies, the adequacy of physical centres, standards of care and accommodation, equipment and personnel. A substantial portion of the fees paid to providers of these services are funded by provincial programs, with a portion to be paid by residents or clients. Each province has a different system for managing the services provided. In some provinces, the government has delegated responsibility for the funding and administration of long-term care programs to regional health authorities. As a result, there can be significant variability in the regulations governing the provision of and reimbursement for care from location to location.

In most provinces, a license must be obtained from the applicable provincial ministry of health in order to operate either a long-term care centre or a retirement centre. In general, there has not been any issuance of new licenses for LTC beds across the country because of the funding implications for governments. In addition to the license procedure, or in some provinces in place of, operators in Alberta, Manitoba, Ontario and Saskatchewan are required to sign service contracts that incorporate service expectations with the provincial government or regional health authority.

In December 2016, Bill 41, *Patients First Act, 2016*, received royal assent, and forms part of the Ontario government's Patients First: Action Plan for Health Care to transform the health care system and create a more patient-centred system in Ontario. The major elements of Bill 41 include the removal of the Community Care Access Centres (CCACs) from the definition of "health services providers", and introduction of rules governing the transfer of the CCACs' assets and staff to the 14 Local Health Integration Networks (LHINs), in addition to increasing the size and span of control of the LHIN boards. In April 2017, the Ontario Ministry of Health and Long-Term Care (the "MOHLTC") approved orders to integrate the CCACs with the LHINs having the same geographic area as the CCAC. The integrations were completed by the end of June 2017, resulting in the LHINs now being accountable for home health care and the coordination of a person's placement in an LTC centre. The government's focus has now shifted to the next steps in the transformation of the health care system involving enhancing roles of the LHINs to better meet the care needs of the local communities, including among other things, the establishment of patient and family advisory committees and geographic sub-regions. The government continues to stress its commitment to the expansion of the home health care sector and to work with all parties in completing the transformational work. Extendicare has strong relationships with all of the LHINs and does not anticipate any material adverse impact from the implementation of Bill 41.

In November 2017, Bill 148, *Fair Workplaces, Better Jobs Act, 2017* (the "Act"), received royal assent, and came into effect in 2018. The Act contains a number of amendments to both the *Employment Standards Act* and the *Labour Relations Act,* as part of the Ontario government's efforts to overhaul workplace laws. These changes include, among other things, an increase in minimum wage to $14 per hour that took effect on January 1, 2018, with a further increase to $15 per hour on January 1, 2019, revisions to vacation, holiday pay and personal leave entitlements that took effect on January 1, 2018, equal pay for equal work standards to take effect on April 1, 2018, and amendments to schedule change notifications and minimum "on call" payments to take effect on January 1, 2019, in addition to lower voting thresholds for unionization. Operationally, the Act will necessitate changes in the manner in which the Company manages its workforce in a number of business areas and could otherwise subject the Company to increased unionization. Financially, the Company expects that the impact of the Act on its private-pay businesses will not be significant, and that the impact on its government-funded long-term care and home health care businesses will be offset by funding under its current government service contracts. There can, however, be no assurance that any such funding will be commensurate with the Company's additional costs to service resulting from such legislative changes. While the Company does not anticipate the increases to the minimum wage will have a significant impact on the financial results given the current pay rates of its workforce, there can be no assurance that these changes will not necessitate increased pay rates for those already above the minimum wage, in order for the Company to retain and attract employees. As the Company's labour costs account for approximately 87% of its operating costs, increased labour costs could have a significant adverse effect on the Company's results from operations and cash flows, should such cost increases not be met with commensurate increases in government funding. Management is unable to predict the nature and extent of any changes the government may make to its funding programs or the effect of any such changes on the Company, but expects that the government will comply with its contractual obligations relating thereto.

In December 2017, Bill 160, *Strengthening Quality and Accountability for Patients Act,* received royal assent and the regulations associated therewith are currently being drafted. Bill 160, which supports the Ontario government's Patients First: Action Plan for Health Care, includes new legislation as well as changes to a number of existing pieces of legislation. Bill 160, among other things, provides updates to the *Long-Term Care Homes Act, 2007* (LTCHA) to add new enforcement tools, including financial penalties, and new provincial offences to ensure operators are addressing concerns promptly. The legislation also includes a consent-based framework to protect residents who need to be secured in a LTC centre for safety reasons. In addition, Bill 160 provides updates to the *Retirement Homes Act, 2010* that would strengthen the oversight powers of the Retirement Homes Regulatory Authority (RHRA) and increase transparency, accountability and governance of the RHRA.

Ontario Redevelopment Program

In February 2015, the MOHLTC released updates to its plan to redevelop approximately 31,000 older long-term care beds by the end of 2025. The new per diem construction funding subsidy includes: an increase to the base rate from $13.30 to $16.65 per bed for large centres of 161 beds or more; an incremental per diem of $1.50 per bed for small centres with up to 96 beds; an incremental per diem of $0.75 per bed for medium centres with 97 to 160 beds; and a per diem of up to $0.38 per bed for those centres eligible for enhanced transition support. In addition, LTC centres are no longer required to meet Leadership in Energy and Environmental Design, or LEED, construction standards; however, those that achieve LEED Silver status will continue to receive a per diem premium of $1.00 per bed. Following their redevelopment, LTC centres meeting the enhanced design standards will be eligible to receive a 30-year license.

In November 2017, the MOHLTC announced plans for 5,000 new LTC beds by 2022 and 30,000 new beds over the next decade, and in February 2018 put out a call for applications (CFA) related to the 5,000 new LTC beds, indicating the prioritization for applications where an increase in needed capacity has been established. Applications can be submitted by parties interested in developing new LTC centres and/or expanding the capacity of LTC centres to be redeveloped.

During 2016, we formalized a plan to redevelop our 21 Class C LTC centres (3,287 beds) in Ontario under the government's enhanced redevelopment program. To date, we have requested approval from the MOHLTC to move ahead with the redevelopment of 16 of our existing Class C centres. With the MOHLTC's announcement of 5,000 new LTC beds, we have modified our redevelopment plans to request additional beds for some of our redevelopment projects. In addition, as part of the Company's approach to campus of care, we plan to participate in requests for beds in new developments where market opportunity exists. Each project is unique and the overall plan involves a combination of renovations and new construction. While factors could arise that affect the timing or sequence of this plan, we are working closely with the MOHLTC with a goal to accelerating our efforts to redevelop these centres. As these redevelopment projects are completed, we expect to realize the benefit of improved performance and extended license terms. As at February 28, 2018, we have received confirmation from the MOHLTC that six of our applications have advanced to the next stage of the MOHLTC's review process which, upon completion, will result in license transfer approval and commencement of construction.

Ontario Long-term Care Funding

Ontario is Extendicare's largest market for its senior care services. Funding for LTC centres in Ontario is based on reimbursement for the level of care assessed to be required by the residents, in accordance with scheduled rates. The MOHLTC allocates funds through "funding envelopes", specifically: nursing and personal care (NPC); programs and support services (PSS); and accommodation (which includes a sub-envelope for raw food). The funding for the NPC and PSS envelopes is generally adjusted annually based on the acuity of residents as determined by a classification assessment of resident care needs. The NPC, PSS and food envelopes are "flow-through" envelopes, whereby any deviation in actual costs from scheduled rates is either absorbed by the provider (if actual costs exceed funding allocations) or is returned to the MOHLTC (if actual costs are below funding allocations). With respect to the accommodation envelope, providers retain any excess funding received over costs incurred. The province sets the rates for standard accommodation, as well as the maximum amounts that a provider can charge for semi-private and private accommodation (preferred accommodation). The provider is permitted to bill and retain the premiums charged for preferred accommodation. The accommodation rates are substantially paid for by the resident; however, the province guarantees funding for standard accommodation through resident subsidies. Overall government funding is occupancy-based, but once the average occupancy level of 97% or higher for the calendar year is achieved, operators receive government funding based on 100% occupancy. In addition, under the MOHLTC's occupancy protection program, providers with occupancy levels equal to 90% and less than 94% receive funding based on their actual occupancy plus 1%, and those with occupancy levels equal to 94% and less than 97% receive funding based on their actual occupancy plus 2%. In 2017, all but two of Extendicare's LTC centres in Ontario achieved the 97% occupancy threshold.

On April 1st each year, the MOHLTC generally provides flow-through funding adjustments on the government funded portion of the fees. Funding for the NPC and PSS flow-through envelopes increased by 2% on April 1, 2017. These funding enhancements, along with our case mix index and re-indexing adjustments, are estimated to provide Extendicare with additional annual revenue of approximately $3.4 million to offset additional costs for resident care and services within the NPC and PSS flow-through envelopes (April 2016 – $1.8 million).

On July 1st each year, the MOHLTC generally implements annual accommodation funding increases to the per diem rates provided to long-term care providers. The July 1, 2017 funding enhancements increased the daily rates for the non flow-through component of the accommodation envelope by $0.76 (1.4%) and by $0.55 (6.5%) for the flow-through food component. Extendicare estimates that this enhanced funding represents additional annual revenue of approximately $2.5 million in total, of which approximately $1.0 million is flow-through funding (2016 – $1.7 million in total, of which $0.6 million was flow-through).

In addition, LTC operators in Ontario are permitted to designate up to 60% of the resident capacity of a centre as preferred accommodation and charge higher accommodation rates that vary according to the structural classification of the LTC centre. For beds that are not classified as "New" or "A" beds, the maximum preferred accommodation premiums increased effective July 1, 2017, by $0.11 to $8.20 per day for a semi-private room and by $0.25 to $18.45 per day for a private room. For beds that are classified as "New" and "A" beds, the maximum preferred accommodation premiums increased effective July 1, 2017, by $0.17 to $12.30 per day for a semi-private room and by $0.35 to $25.63 per day for a private room. Extendicare has 13 "New" LTC centres in Ontario with 1,847 beds, of which 1,099 are private beds. We will benefit from this premium increase for preferred accommodation over time as new residents are admitted.

Alberta Long-term Care Funding

Alberta is Extendicare's second largest market for its senior care services. Since April 2010, AHS has been using an activity-based funding system for continuing care centres that includes the measurement of a resident's acuity through the use of a resident assessment instrument – minimum data set, or RAI-MDS, to determine the resident's level of care and resources required. The Alberta Continuing Care Association is actively engaged in discussions with the Alberta Government and AHS to further enhance care funding to accommodate higher expenses within continuing care, and to revise the existing funding model used within continuing care. It was anticipated that a revised care funding model would be implemented for fiscal 2016/2017; however, following receipt of public input to inform new or revised legislation, the provincial government has publicly indicated that it will release its strategy related to continuing care in 2018 that will outline its approaches affecting long-term care in the future.

In March 2017, the AHS issued retroactive funding adjustments for long-term care and designated supportive living providers for fiscal 2015/2016 and 2016/2017 in recognition of labour contract settlements. As a result, Extendicare received prior period funding of $0.8 million, and an estimated increase in ongoing annual revenue of $0.5 million. In addition, the government announced its annual funding changes for fiscal 2017/2018, effective April 1, 2017, incorporating changes to the case mix index, occupancy and an inflationary component. The Company estimates that the April 1, 2017 funding changes represent additional annual revenue of approximately $0.9 million (April 2016 – $1.2 million).

Beginning on July 1, 2017, the annual accommodation charge adjustments (the portion paid directly by residents of long-term care and designated supportive living centres) increased by 2.2%, based on inflation as reflected by Alberta's CPI. Extendicare estimates that the 2.2% increase represents additional revenue of approximately $0.6 million (July 2016 – $0.9 million).

Ontario Home Health Care Funding

Extendicare's ParaMed Home Health Care division operates in six provinces across Canada, currently providing approximately 11.3 million hours of care annually, which we believe makes ParaMed the largest private-sector provider of publicly funded home health care in Canada, and the largest in Ontario. Based on the service volumes provided in 2017, the Ontario market represents approximately 83% of ParaMed's service volumes, of which approximately 98% are received from government-funded contracts at specified rates, and the remainder from private-pay clients.

In shaping the delivery of health care to Canadians, both the federal and provincial governments have stated that home health care is an area that merits further investment to ensure that more health care services are available in the home. Recent health accord agreements reached between the federal government and each of the provinces beginning in fiscal 2017/2018, included targeted funding for home health care. For Ontario alone, targeted home health care funding has been reported as an additional $2.3 billion over the next decade. As additional funds are allocated by governments to this segment of the Canadian health care system, Extendicare anticipates ParaMed's business will continue to grow. ParaMed is looking at a number of private-pay home health care opportunities to further leverage its platform.

In October 2017, the MOHLTC re-announced its investment of $100 million in fiscal 2017/2018 in home care supports and services. The funding is expected to support 1.5 million additional hours of personal support, 390,000 additional hours of nursing care, 110,000 additional hours of rehabilitation, and 600,000 additional hours of respite services for caregivers. As part of the initiative to expand home health care, the MOHLTC announced two new self-directed care initiatives involving: i) a self-directed care program (SDC Program) for eligible clients (children and clients in exceptional circumstances) that involves direct funding; and ii) the creation of a self-directed care organization (SDCO) to provide eligible clients with the opportunity to receive their personal support services from a new provincial agency, that does not include a direct funding component. In both instances, the LHINs will continue to conduct the client assessments and coordinate the care plans. Under the SDC program, eligible clients will be provided with direct funding to purchase services in their care plan or to employ people to provide those services. Under the SDCO initiative, eligible clients will have the option to receive personal support services from the SDCO, or to opt for the traditional care model currently managed through the LHINs. The MOHLTC is proposing that only clients with a high volume of personal support service needs (6 months or longer; and requiring 14 hours or more of personal support services per week) will be eligible for this new program, and estimates that the total number of eligible clients will be approximately 6,000 individuals province wide, representing approximately 1% of the individuals the government estimates it provides home health care services to in the province. The number of clients who will choose to participate in this program is not yet known, but the MOHLTC has indicated that it anticipates only a minority of eligible clients will change from the traditional care. The timing of the provision of services by the SDCO will be phased in, starting with pilot projects in three LHINs expected to begin in the spring of 2018. While ParaMed has continued to experience year-over-year growth in its Ontario government volumes, management cannot predict how funding will be directed by the LHINs, or how many additional hours are expected to be implemented and directed to existing service providers.

The Ontario government's rates for home health care services were pre-determined between the former CCACs and the service providers, with varying rates for each contract awarded, and had remained static since they were last contracted for under the competitive bidding model. Based upon a recommendation from the Auditor General's special report on the former CCACs in September 2015, the MOHLTC implemented harmonized billing rates for specific personal support services during the second and third quarters of 2017, retroactive to April 1, 2017. This change has not resulted in any significant overall impact on the Company's home health care revenues.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes the sources and uses of cash between our continuing and discontinued operations for each of 2017 and 2016.

			2017			2016
(thousands of dollars unless otherwise noted)	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Cash provided by operating activities, before working capital changes and interest and income taxes	**99,333**	–	**99,333**	93,876	(904)	92,972
Net change in operating assets and liabilities						
Accounts receivable	**9,569**	–	**9,569**	(9,150)	831	(8,319)
Other assets	**4,283**	–	**4,283**	14,108	458	14,566
Accounts payable and accrued liabilities	**(6,144)**	–	**(6,144)**	(33,807)	217	(33,590)
	7,708	–	**7,708**	(28,849)	1,506	(27,343)
Interest, taxes and claims payments						
Interest paid	**(29,560)**	–	**(29,560)**	(26,524)	(16)	(26,540)
Interest received	**3,932**	–	**3,932**	10,835	–	10,835
Income taxes paid	**(10,093)**	–	**(10,093)**	(16,627)	(10)	(16,637)
Payments for U.S. self-insured liabilities	–	**(24,160)**	**(24,160)**	–	(32,976)	(32,976)
	(35,721)	**(24,160)**	**(59,881)**	(32,316)	(33,002)	(65,318)
Net cash from operating activities	**71,320**	**(24,160)**	**47,160**	32,711	(32,400)	311
Net cash from investing activities	**(18,564)**	**24,160**	**5,596**	(58,514)	41,072	(17,442)
Net cash from financing activities	**(23,612)**	–	**(23,612)**	16,065	(257)	15,808
Net cash from discontinued operations	–	–	–	8,415	(8,415)	–
Foreign exchange loss on U.S. cash held	**(2,570)**	–	**(2,570)**	(717)	–	(717)
Increase (decrease) in cash and short-term investments	**26,574**	–	**26,574**	(2,040)	–	(2,040)
Cash and short-term investments at beginning of year	**101,582**	–	**101,582**	103,622	–	103,622
Cash and short-term investments at end of year	**128,156**	–	**128,156**	101,582	–	101,582
Average U.S./Canadian dollar exchange rate			**1.2986**			1.3248

As at December 31, 2017, Extendicare had cash and short-term investments on hand of $128.2 million compared with $101.6 million at the beginning of the year, resulting in an increase in cash of $26.6 million. Cash flow generated by the operating activities of our continuing operations of $71.3 million was in excess of our cash dividends paid of $37.5 million by $33.8 million. The issuance of long-term debt of $43.7 million and repatriation of $21.1 million of funds from the Captive primarily supported the capital expenditures, principal debt repayments, and the purchase of shares for cancellation under our normal course issuer bid.

Discontinued operations reflect the payment of claims for self-insured liabilities as a component of net cash from operating activities, which are funded by the Captive's investments held for self-insured liabilities as a component of net cash from investing activities, as those invested funds are not included in cash and short-term investments. In addition, the 2016 activity for discontinued operations included the operations of our former U.S. IT Hosting business that was sold in December 2016.

Net cash from operating activities of the continuing operations was a source of cash of $71.3 million in 2017 compared to $32.7 million in 2016. The improvement of $38.6 million was primarily due to an improvement in earnings and a favourable net change in operating assets and liabilities of $36.6 million. The 2016 change in accounts payable and accrued liabilities included payments of $19.4 million that were funded by cash held in escrow that was recognized as a source of cash from investing activities, as described below. The 2016 net cash from operating activities of $32.7 million, would have otherwise been $52.1 million.

Net cash from investing activities of the continuing operations was a use of cash of $18.6 million in 2017 compared to a use of cash of $58.5 million in 2016. The 2017 activity included the repatriation of the Captive's funds of $21.1 million (US$16.0 million) and the collection of other assets, offset by purchases of property, equipment and other intangible assets of $41.1 million. The 2016 activity included the acquisition of two retirement communities for $40.5 million in February 2016, taxes paid of $10.8 million in connection with the U.S. Sale Transaction, and purchases of property, equipment and other intangible assets of $37.4 million, partially offset by a release of funds held in escrow of $19.4 million (US$14.0 million) to support obligations assumed in respect of the disposed U.S. operations, the transfer of $6.6 million from the Captive's investments held for self-insured liabilities, and the collection of other assets.

The following table summarizes the components of our property, equipment and other intangible asset expenditures between our continuing and discontinued operations for each of 2017 and 2016. Growth capex, excluding acquisitions, relates to the construction of new beds, building improvements or other capital costs, all of which are aimed at earnings growth. The increase in growth capex relates primarily to the retirement communities currently under development in Ontario. Maintenance capex relates to our actual capital expenditures incurred to sustain and upgrade existing property and equipment. Management monitors the capital expenditure requirements of its properties throughout the year, and prioritizes its capital projects taking into account the urgency and necessity of the expenditure. In 2018, we are projecting to spend in the range of $9 million to $10 million in maintenance capex, and in the range of $50 million to $55 million in growth capex related primarily to the retirement development projects.

	2017			2016
(thousands of dollars)	**Total Continuing**	**Continuing**	**Discontinued**	**Total**
Growth Capex				
Canadian operations	**33,521**	26,259	–	26,259
U.S. operations	–	–	704	704
Deduct: capitalized interest	**(1,197)**	(979)	–	(979)
Growth capex	**32,324**	25,280	704	25,984
Maintenance Capex				
Canadian operations	**8,813**	12,119	–	12,119
U.S. operations	–	–	734	734
Maintenance capex	**8,813**	12,119	734	12,853
	41,137	37,399	1,438	38,837

Net cash from financing activities of the continuing operations was a use of cash of $23.6 million in 2017 compared to a source of cash of $16.1 million in 2016. The 2017 activity included scheduled debt repayments of $22.0 million, cash dividends paid of $37.5 million, and Common Shares acquired for cancellation under a normal course issuer bid at a cost of $6.5 million, partially offset by the net issuance of $26.4 million on refinancing of long-term debt, and draws on construction financing of $17.3 million. The 2016 activity included the issuance of the Retirement Mortgages of $56.3 million, $12.6 million in draws on construction financing, and a release of restricted cash of $4.8 million, partially offset by scheduled debt repayments of $21.0 million and cash dividends paid of $36.1 million. For information on the change in long-term debt, refer to "Liquidity and Capital Resources – Long-term Debt".

Net cash from discontinued operations impacting the cash from continuing operations reflects the intercompany movements of cash between the discontinued and continuing operations. The 2016 activity of $8.4 million related to the net proceeds from the sale of our U.S. IT Hosting business of $9.5 million, partially offset by the net change in cash of those operations during 2016.

Capital Structure

The following table summarizes our shareholders' equity for 2017 and 2016.

(thousands of dollars unless otherwise noted)	**2017**	**2016**
Shareholders' Equity		
Common Shares	**490,881**	489,656
Equity portion of convertible debentures	**5,573**	5,573
Contributed surplus	**2,437**	941
	498,891	496,170
Accumulated deficit at beginning of year	**(322,025)**	(315,051)
Net earnings for the period	**2,132**	35,452
Dividends declared	**(42,583)**	(42,422)
Purchase of Common Shares in excess of book value and other	**(2,608)**	(4)
Accumulated deficit at end of year	**(365,084)**	(322,025)
Accumulated other comprehensive income	**(4,851)**	614
Shareholders' equity	**128,956**	174,759
U.S./Canadian dollar exchange rate at end of year	**1.2571**	1.3427

Share Information *(thousands)*	**February 27, 2018**	**December 31, 2017**	December 31, 2016
Common Shares (TSX symbol: EXE) (1)	**88,266.5**	**88,523.3**	**88,684.5**

(1) Closing market value per the TSX on February 27, 2018, was $8.14.

The closing rates used to translate assets and liabilities of the U.S. operations were 1.2571 at December 31, 2017, and 1.3427 at December 31, 2016. As a result of the stronger Canadian dollar at the end of 2017, compared to the end of 2016, the foreign currency translation adjustment account declined by $3.1 million due to the devaluation in net assets of our continuing self-sustaining U.S. operations, representing an increase (decrease) in net assets of approximately $0.2 million for every one-cent weakening (strengthening) of the Canadian dollar against the U.S. dollar.

DISTRIBUTIONS

The declaration and payment of distributions is at the discretion of our board of directors (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 our Board determines that it would be in Extendicare's best interests, it may modify the amount and frequency of dividends to be distributed to holders of Common Shares.

In each of 2017 and 2016, the Company declared cash dividends of $0.48 per share, for a total of $42.6 million and $42.4 million, respectively. The portion distributed in cash in 2017 was $37.5 million (2016 – $36.3 million), and $5.1 million (2016 – $6.1 million) was by way of shares issued under a dividend reinvestment plan. A total of 535,025 Common Shares were issued in 2017 through the dividend reinvestment plan (2016 – 731,194 Common Shares).

Net cash from operating activities was $47.2 million in 2017 and $0.3 million in 2016. In both periods, cash from operating activities included deductions for working capital payments that were funded by cash from investing activities on the statements of cash flows. These payments related to our U.S. self-insured liabilities of $24.2 million in 2017 and $33.0 million in 2016, which were fully funded from investments held by the Captive. In addition, payments made in 2016 to settle obligations of the former U.S. operations were funded from cash held in escrow of $19.4 million. Cash flow generated from the operating activities of our continuing operations, excluding these items that were funded from investment activities, were $71.3 million in 2017 and $52.1 million in 2016, each of which were in excess of the cash dividends declared. For further information on the sources and uses of cash between our continuing and discontinued operations, refer to the previous discussion under the heading "Liquidity and Capital Resources".

Compared to our AFFO of $58.5 million for 2017 (2016 – $65.0 million), dividends declared of $42.6 million represented a payout ratio of approximately 73% (2016 – 65%). For further information on our AFFO, refer to the discussion under the heading "Adjusted Funds from Operations".

NORMAL COURSE ISSUER BID

During 2017, under a normal course issuer bid that commenced on January 13, 2017 and ended on January 12, 2018, the Company purchased and cancelled 696,220 Common Shares at a weighted average price of $9.27 per share, for a total cost of $6.5 million. During 2016, the Company did not acquire any Common Shares for cancellation.

On January 10, 2018, Extendicare received the approval of the TSX to renew its normal course issuer bid (the "Bid") to purchase for cancellation up to 8,770,000 Common Shares (approximately 10% of the public float) through the facilities of the TSX, and on alternative Canadian trading systems. The Bid commenced on January 15, 2018, and provides Extendicare with flexibility to purchase Common Shares for cancellation until January 14, 2019, or on such earlier date as the Bid is complete. Subject to the TSX's block purchase exception, on any trading day, purchases under the Bid will not exceed 39,219 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 will be cancelled. As at February 28, 2018, the Company has acquired and cancelled 352,233 Common Shares under the Bid at an average price of $8.94 per share, for a total cost of $3.1 million, all of which were acquired in January 2018.

Future Liquidity and Capital Resources

Extendicare's consolidated cash and short-term investments on hand was $128.2 million as at December 31, 2017, compared with $101.6 million at the beginning of the year, and excluded restricted cash of $2.3 million, and $86.3 million (US$68.6 million) of investments held by our Captive to support the accrual for U.S. self-insured liabilities of $61.1 million (US$48.6 million). In addition, the Company has $65.0 million undrawn on its ParaMed Credit Facility.

The Company has acquired six retirement communities since October 2015, for cash of approximately $139 million. In August 2016, the Company secured financing in the aggregate of $56.3 million on three of the retirement communities, representing approximately 71% of their acquisition costs. The Company has the opportunity to seek financing on the remaining three once stabilized.

The Company anticipates closing on the acquisition of the Lynde Creek Retirement Community for a cash purchase of $34.5 million in the second quarter of 2018, following which it intends to secure financing. Refer to the "Retirement Acquisitions" heading under the "Significant 2017 Events and Developments – Growth of Retirement Operations" section of this MD&A for further details.

In addition, construction financings in the aggregate of up to $60.4 million have been secured on three of the Company's four retirement development projects, of which $29.9 million was drawn as at December 31, 2017. As at December 31, 2017, the Company had incurred approximately $62.1 million of the estimated $125.0 million of Adjusted Development Costs for these four retirement communities.

Management is confident that cash from operating activities and future debt financings will be available and sufficient to support Extendicare's ongoing business operations, maintenance capex, debt repayment obligations, growth capex and to fund strategic acquisitions.

COMMITMENTS AND CONTINGENCIES

Long-term Debt

CONTINUITY OF LONG-TERM DEBT

The following summarizes the changes in the carrying amounts of long-term debt for 2017 and 2016. Long-term debt totalled $536.1 million as at December 31, 2017, compared with $503.6 million as at December 31, 2016, representing an increase of $32.5 million primarily due to the issuance of the CIBC Term Loan, an increase in finance lease obligations for customized cloud-based software, and a draw on construction loans, partially offset by scheduled debt repayments of $22.0 million. Extendicare and its subsidiaries are in compliance with all of their respective financial covenants as at December 31, 2017. Details of the components, terms and conditions of long-term debt are provided in *note 12* of the audited consolidated financial statements.

(millions of dollars)	**2017**	**2016**
Long-term debt at beginning of year, prior to financing costs	**510.3**	461.6
Issue of long-term debt		
CIBC Term Loan	**26.4**	–
Retirement Mortgages	**–**	56.3
Construction loans	**17.3**	12.6
Finance lease obligations	**8.9**	–
Repayment of long-term debt	**(22.0)**	(21.0)
Accretion of convertible debentures	**0.9**	0.8
	541.8	510.3
Financing costs at end of year	**(5.7)**	(6.7)
Long-term debt at end of year	**536.1**	503.6
Less: current portion	**(59.7)**	(54.8)
	476.4	448.8

LONG-TERM DEBT MATURITIES AND WEIGHTED AVERAGE INTEREST RATES

Management has limited the amount of debt that may be subject to changes in interest rates, with all of its debt at fixed rates, other than the construction loans of $29.9 million. The variable-rate Retirement Mortgages and CIBC Term Loan aggregating $85.6 million as at December 31, 2017, have effectively been converted to fixed rate financing with interest rate swaps over the full term. As at December 31, 2017, the interest rate swaps were valued as an asset of $3.5 million.

The following table summarizes key metrics of our consolidated long-term debt as at December 31, 2017, and December 31, 2016.

	December 31, 2017	**December 31, 2016**
Weighted average interest rate of long-term debt outstanding	**5.0%**	5.2%
Weighted average term to maturity of long-term debt outstanding	**7.1 yrs**	7.8 yrs
Weighted average term to maturity of long-term debt outstanding, excluding finance lease obligations	**6.7 yrs**	7.2 yrs
Trailing twelve months consolidated net interest coverage ratio (1)	**3.8 X**	5.4 X
Trailing twelve months consolidated interest coverage ratio (2)	**3.3 X**	3.3 X
Debt to Gross Book Value (GBV)		
Total assets (carrying value)	**934,281**	988,617
Accumulated depreciation on property and equipment	**214,889**	197,476
Accumulated amortization on other intangible assets	**12,229**	7,905
GBV	**1,161,399**	1,193,998
Debt (3)	**543,446**	512,898
Debt to GBV	**46.8%**	43.0%

(1) Net interest coverage is defined as Adjusted EBITDA divided by net interest (interest expense before reduction of capitalized interest, net of interest revenue).
(2) Interest coverage is defined as Adjusted EBITDA divided by interest expense before reduction of capitalized interest.
(3) Debt includes convertible debentures at face value of $126.5 million, and excludes finance costs.

The table below presents the principal, or notional, amounts and related weighted average interest rates by year of maturity, of the Company's long-term debt obligations as at December 31, 2017.

(millions of dollars unless otherwise noted)	**2018**	**2019**	**2020**	**2021**	**2022**	**After 2022**	**Total**	**Fair Value**
Convertible debentures (at face value)								
Fixed rate	–	126.5	–	–	–	–	**126.5**	129.7
Average interest rate	–	6.00%	–	–	–	–	**6.00%**	
Long-term debt								
Fixed rate (including fixed through swap)	22.7	14.0	58.5	13.5	55.8	132.3	**296.8**	299.4
Average interest rate	4.13%	4.21%	4.05%	4.24%	3.71%	4.71%	**4.20%**	
Variable rate	29.9	–	–	–	–	–	**29.9**	29.9
Average interest rate	3.87%	–	–	–	–	–	**3.87%**	
Finance lease obligations								
Fixed rate	8.5	8.5	9.1	9.6	8.6	46.0	**90.3**	103.0
Average interest rate	5.97%	6.23%	6.26%	6.29%	7.00%	6.98%	**6.67%**	

Other Contractual Obligations and Contingencies

The table below provides summary information relating to the contractual obligations, other than long-term debt, as at December 31, 2017. Due to the uncertainty as to the timing of payments to be made with respect to certain obligations, the table excludes our accrual for U.S. self-insured liabilities of $61.1 million and our decommissioning provisions of $9.2 million. In addition, the table excludes our defined benefit pension plan obligations, which are described more fully below.

(millions of dollars)	**2018**	**2019**	**2020**	**2021**	**2022**	**After 2022**	**Total**
Operating lease obligations	3.3	2.9	1.2	0.9	0.5	0.1	**8.9**
Purchase obligations	45.1	10.9	–	–	–	–	**56.0**
	48.4	13.8	1.2	0.9	0.5	0.1	**64.9**

DEFINED BENEFIT PENSION PLAN OBLIGATIONS

The contractual obligations table excludes our defined benefit pension plan obligations. The accrued benefit liability on our statement of financial position as at December 31, 2017, was $36.6 million (2016 – $37.0 million). We currently have defined benefit registered and supplementary plans covering certain executives, both of which have been closed to new entrants since 2000. The registered defined benefit plan was in an actuarial deficit of $2.5 million with plan assets of $5.4 million and accrued benefit obligations of $7.9 million as at December 31, 2017 (2016 – an actuarial deficit of $2.3 million with plan assets of $5.4 million and accrued benefit obligations of $7.7 million). The accrued benefit obligations of the supplementary plan were $34.1 million as at December 31, 2017 (2016 – $34.7 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 a letter of credit totalling $39.9 million as at December 31, 2017 (2016 – $40.4 million). This letter of credit renews annually in May based on an actuarial valuation of the pension obligations. The annual benefit payments under the supplementary pension plan to be funded from cash from operations over the next five years are expected to be in the range of $2.0 million to $2.2 million, and the annual contributions to the registered pension plan over the next five years are expected to be less than $0.1 million. Since the majority of our accrued benefit obligations represent our obligation under our non-registered supplementary plan, which is not required to be funded, changes in future market conditions are not expected to have a material adverse effect on our cash flow requirements with respect to our pension obligations, or on our pension expense.

ACCRUAL FOR U.S. SELF-INSURED LIABILITIES

The obligation to settle any U.S. self-insured general and professional liability claims relating to the period prior to the closing of the U.S. Sale Transaction, including claims incurred but yet to be reported, remains with Extendicare, which it intends to fund through the Captive. Consequently, the balance of the accrual for self-insured liabilities and the related investments held for self-insured liabilities remain on the consolidated statement of financial position. However, any expense incurred or release of reserves for U.S. self-insured liabilities are presented as discontinued operations; while the Captive's costs to administer and manage the settlement of the remaining claims are reported as continuing operations within the U.S. segment.

Management regularly evaluates and semi-annually engages an independent third-party actuary to provide a report to determine the appropriateness of the carrying value of this liability. Our most recent independent actuarial review was conducted at the end of the 2017, which confirmed the adequacy of our reserves.

As at December 31, 2017, the accrual for self-insured general and professional liabilities was $61.1 million (US$48.6 million) compared to $94.8 million (US$70.6 million) at the beginning of the year. The decline of US$22.0 million reflected claim payments of US$18.6 million and a release of reserves of US$4.4 million, partially offset by accretion of the discounted liability. The release of reserves of $5.7 million (US$4.4 million) was reflected in discontinued operations in 2017 following the completion of independent actuarial reviews.

During 2016, payments for self-insured liabilities were $33.0 million (US$24.9 million) and US$11.5 million in reserves were released following the completion of independent actuarial reviews. The release of reserves together with an adjustment for the discount rate applied to the liability, totalling $16.8 million (US$12.7 million), were reflected in discontinued operations.

Most of the risks that Extendicare self-insures are long-term in nature, and accordingly, claim 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, 2017, management estimated that approximately $22.7 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; 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 required statutory solvency and liquidity ratios. These invested funds are reported in other assets and totalled $86.3 million (US$68.6 million) as at December 31, 2017, compared to $136.1 million (US$101.4 million) as at December 31, 2016. During the 2017, the Captive transferred US$16.0 million of its funds previously held for investment to the Company for general corporate use. Management believes there are sufficient invested funds held to meet estimated current claims payment obligations.

LEGAL PROCEEDINGS, CLAIMS AND REGULATORY ACTIONS

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. The Company is aware that a statement of claim was filed against it in Ontario in late November 2017, which seeks an order certifying the action as a class action. The statement of claim, which has not been served on Extendicare, alleges negligence by the Company in the operation of its long-term care facilities and its provision of care to residents, and is seeking $150 million in damages. Management is unable to assess whether the claim will be advanced but believes that the allegations, including the damages sought, are completely without merit. Should the claim be advanced, Extendicare intends to vigorously defend itself and does not believe the outcome will have a material adverse impact on its business, results of operations or financial condition and believes that any potential liability will be covered by insurance.

The provision of health care services is subject to complex government regulations. Every effort is made by the Company to avoid or mitigate deficiencies in the quality of patient care through quality assurance strategies and to remedy any such deficiencies cited by government inspections within any applicable prescribed time period. Extendicare accrues for costs that may result from investigations (or any possible related litigation) to the extent that an outflow of funds is probable and a reliable estimate of the amount of the associated costs can be made.

RELATED PARTY TRANSACTIONS

Tim Lukenda, Extendicare's President and Chief Executive Officer, and members of his family have a company that owns a long-term care centre and a retirement centre in Ontario, in which Mr. Lukenda has an approximate 7.1% direct and indirect ownership interest, and with which Extendicare has an ongoing relationship through the provision of management services to the LTC centre and group purchasing services to the retirement centre. Mr. Lukenda's employment contract provides a mechanism and process that effectively removes him from the decision-making process in situations where a conflict of interest may arise on any matter between the two companies.

In 2017, contingent on his continued employment as of September 30, 2017, our CEO was paid $2.0 million, which amount is reflected above as part of short-term benefits.

RISKS AND UNCERTAINTIES

There are certain risks inherent in the activities of Extendicare, including the risks described below.

General Business Risks

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

In addition, there are inherent legal, reputational and other risks involved in providing housing and health care services to seniors. The vulnerability and limited mobility of some seniors enhances such risks. Such risks include fires or other catastrophic events at a property which may result in injury or death, negligent or inappropriate acts by employees or others who come into contact with our residents, and unforeseen events at Extendicare's centres that result in damage to Extendicare's brand or reputation or to the industry as a whole.

Risks Related to Growth Activities

The Company expects that it will continue to have opportunities to acquire businesses and properties, develop properties, expand existing centres, and grow its home health care, management, consulting and group purchasing businesses, but there can be no assurance that this will be the case.

The provinces restrict the number of licensed LTC beds and any new licenses are awarded through a request for proposal process. If regulatory 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.

The success of the business acquisition and development activities of the Company, including the expansion of its private-pay retirement operations, will be determined by numerous factors, including the ability of the Company to identify suitable acquisition targets, competition for acquisition and development opportunities, purchase price, ability to obtain external sources of funding or adequate financing on reasonable terms, the financial performance of the businesses or centres after acquisition or development, and the ability of the Company to effectively integrate and operate the acquired businesses or centres. Acquired businesses or centres, and development projects, may not meet financial or operational expectations due to the possibility that the Company has insufficient management expertise to engage in such activities profitably or without incurring inappropriate amounts of risk, unexpected costs or delays associated with their acquisition or development, as well as the general investment risks inherent in any real estate investment or business acquisition. Moreover, new acquisitions may require significant management attention, place additional demands on the Company's resources, systems, procedures and controls, and capital expenditures that would otherwise be allocated by the Company in a different manner to existing businesses. Any failure by the Company to identify suitable candidates for acquisition, secure financing, or operate the acquired businesses effectively may have an adverse effect on the future growth, results of operations and financial condition of the Company.

The success of the Company's ability to grow its management, consulting, group purchasing and home health care businesses, including the private-pay home health care segment, will be determined by numerous factors, including the ability of the Company to retain, renew and secure new contracts, identify suitable markets, develop competitive services and marketing and pricing strategies, attract and retain clients, and hire, retain and motivate key personnel. Changes in government regulations and funding policies, in addition to the financial performance of the business, also impact growth potential. Any failure by the Company to grow or operate its businesses effectively may have an adverse effect on the business, results of operations and financial condition of the Company.

Risks Related to Occupancy and Business Volumes

Senior care providers compete primarily on a local and regional basis with many other health care, long-term care and retirement living providers, including profit-oriented and not-for-profit organizations, hospital-based LTC units, rehabilitation hospitals, home health care agencies, and rehabilitative therapy providers. Our ability to compete successfully varies from location to location and depends on a number of factors, including the number of competitors in the local market, the types of services available, our local reputation for quality care, the commitment and expertise of our staff, our local service offerings, the cost of care in each locality, and the physical appearance, location, age and condition of our centres. Increased competition could limit our ability to attract and retain residents and clients, maintain or increase occupancy levels and business volumes, and expand our business. Our ability to continue to attract residents and clients could have an adverse effect on the business, results of operations and financial condition of the Company.

Risks Related to Government Funding and Regulatory Changes

GENERAL

Extendicare's earnings are highly reliant on government funding and reimbursement programs, 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 costs account for a significant portion of our operating costs (approximately 87% in 2017), government funding constraints, or funding enhancements that are not commensurate with increased costs, could have a significant adverse effect on the Company's 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 Funding Changes Affecting Results".

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 various government funding programs. Long-term care centres must comply with applicable regulations that, depending on the jurisdiction in which they operate, may relate to such matters as staffing levels, resident care related operating standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental and other standards. Retirement communities are also subject to extensive government regulation and oversight, licensure requirements and the potential for regulatory change. 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 centre can be decertified from the funding program. Extendicare makes every effort 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.

The revocation of a license by authorities or the cancellation of a service contract due to inadequate performance by the operator has been historically infrequent and is usually preceded by a series of warnings, notices and other sanctions. Extendicare has never had such a license or service contract revoked in Canada.

Non-compliance with applicable laws and licensure requirements governing LTC centres and retirement communities 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 government funded programs, or one or more third-party payor networks. The Company may be required to refund amounts that have been paid to it by government funded programs. These penalties could have a material adverse effect on the business, results of operations and financial condition of the Company. Extendicare takes all appropriate measures to accrue for costs that may result from investigations (or any possible related litigation) to the extent that an outflow of funds is possible and a reliable estimate of the amount of associated costs can be made; however, there can be no assurance that such accruals are accurate or sufficient.

ONTARIO LTC REDEVELOPMENT PROGRAM

In Ontario, licenses for LTC centres are issued for a fixed term of not more than 30 years, after which a new license may or may not be issued. LTC operators are to be notified of license renewals at least three years prior to the maturity date. Under the LTCHA, license terms for Class B and C LTC centres are set to expire in 2025 unless the centres are redeveloped to the government's new design standards. In Ontario, Extendicare has 21 Class C LTC centres with 3,287 beds that it plans to redevelop under the government's enhanced redevelopment program (see "Ontario Redevelopment Program" under the heading "Update of Regulatory and Funding Changes Affecting Results"). The extent to which such redevelopment plans

are not implemented or proceed on significantly different timing or terms, including levels of expected government subsidy funding, could have a material adverse effect on the business, results of operations and financial condition of the Company.

ONTARIO HOME HEALTH CARE BUSINESS

ParaMed's largest market is in Ontario, where approximately 83% of its service volumes are generated, and approximately 98% of its revenue in Ontario is from contracts tendered by locally administered provincial agencies, or LHINs, at specified billing rates. ParaMed is the largest private-sector provider of publicly funded home health care in the province.

Prior to 2012, government contracts for the provision of home health care services were awarded to service providers, such as ParaMed, under a competitive bidding model, with specified termination dates. In 2012, the government implemented new open-ended contracts for all service providers, whereby the government is required to provide six months' notice of termination, and service providers are required to provide twelve months' notice of their intention to terminate a contract. Any new contracts continue to be awarded under a bidding process to pre-qualified service providers. A service provider's ability to retain its existing business is evaluated based on, among other things, an established set of quality indicators. Under this new regime, all of ParaMed's contracts with the LHINs have remained in effect, and since 2012, it has experienced year-over-year growth in its Ontario business volumes. Any failure by the Company to retain its government contracts may have an adverse effect on the business, results of operations and financial condition of the Company.

Risks of Rising Personnel Costs and Related to Labour Relations

PERSONNEL COSTS

The long-term care industry is labour intensive. The Company's labour costs accounted for approximately 87% of its operating costs and approximately 86% of its combined operating and administrative costs from continuing operations in 2017. The Company competes with other health care providers in attracting and retaining qualified and skilled personnel to manage and operate the day-to-day operations of each of its centres and home health care services. The health care industry continues to face shortages of qualified personnel, such as nurses, certified nurse's assistants, nurse's aides, and therapists. The shortage of qualified personnel and general inflationary pressures may require the Company to enhance its pay and benefits package to compete effectively for such personnel. The Company may not be able to recover such added costs through increased government funding and reimbursement programs, or through increased rates charged to residents and clients. The inability to retain and/or attract qualified personnel and meet minimum staffing levels may result in: a reduction in occupancy levels and volume of services provided; the use of staffing agencies at added costs; an increased risk in the inability to provide continuity of care between our staff and our residents and clients; and an increased risk of an LTC centre or retirement community being subject to fines and penalties. An increase in personnel costs or a failure to attract, train and retain qualified and skilled personnel could adversely affect the business, results of operations and financial condition of the Company.

The Company has contracted out selected dietary and housekeeping services in some of its centres. Should the Company not be satisfied with the quality or cost of the services provided by companies it has contracted out to, it may have to terminate the related contracts and recruit replacement staff at an incremental cost.

LABOUR RELATIONS

The Company employs over 23,700 persons, of whom approximately 58% are represented by labour unions. Labour relations with the unions are governed by numerous collective bargaining agreements and many different unions. There can be no assurance that the Company will not at any time, whether in connection with the renegotiation of a collective bargaining agreement or otherwise, experience strikes, labour stoppages or any other type of conflict with unions or employees which could have a material adverse effect on the Company's business, operating results and financial condition. The centres that Extendicare operates are generally subject to legislation that prohibits both strikes and lock-outs, and requires compulsory arbitration to settle labour disputes. In jurisdictions where strikes and lockouts are permitted, certain essential services regulations apply which provide for the continuation of resident care and most services.

Non-unionized employees of the Company may become unionized if they are targeted for certification by a trade union. There can be no assurance that employees who are not currently unionized will not, in the future, be subject to unionization efforts or that any such efforts will not result in the unionization of such employees, which could increase the Company's labour costs.

Risks Related to Liability and Insurance

The businesses that are carried on by Extendicare, directly or indirectly, entail an inherent risk of liability. Management expects that, from time to time, Extendicare may be, and is in fact from time to time, subject to lawsuits as a result of the nature of its business. Attempts to advance class action lawsuits have become prevalent in the Canadian marketplace, including senior care. There can be no assurance that Extendicare will not face risks of this nature. Refer to the “Legal Proceedings, Claims and Regulatory Actions” heading under the “Other Contractual Obligations and Contingencies – Commitments and Contingencies” section of this MD&A for further details.

Extendicare maintains business and property insurance policies in amounts and with such coverage and deductibles as deemed appropriate, based on the nature and risks of the business, historical experience and industry standards. There can be no assurance, however, that claims in excess of the insurance coverage, or in excess of the Company’s reserves, or claims not covered by the insurance coverage will not arise or that the liability coverage will continue to be available on acceptable terms. 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. A successful claim against the Company not covered by, or in excess of, such insurance, or in excess of the Company’s reserves for self-insured retention levels, could have a material adverse effect on the business, results of operations and financial condition of the Company. Claims against the Company, regardless of their merit or eventual outcome, may also have a material adverse effect on the ability of the Company to attract residents, expand the business of the Company or maintain favourable standings with regulatory authorities.

Prior to the U.S. Sale Transaction, Extendicare self-insured certain risks related to general and professional liability of its disposed U.S. business through the Captive, its Bermuda-based captive insurance company. The obligation to settle any such claims relating to the period prior to the closing of the U.S. Sale Transaction, including claims incurred but yet to be reported, remains with Extendicare, which it intends to fund through the Captive.

Risks Related to Tax Rules and Regulations

Extendicare is subject to audits from federal, state and provincial tax jurisdictions and is therefore subject to risk in the interpretation of tax legislation and regulations. Tax rules and regulations are complex and require careful review by the Company’s tax management and its external tax consultants. Differences in interpretation of 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.

During the 2015 third quarter, Extendicare recorded a provision of $3.6 million for the full amount of taxes in dispute, including interest, in respect of a CRA reassessment. In 2016, the Company’s notice of objection to appeal the reassessment was accepted by the CRA, resulting in the reversal of the $3.6 million provision in the 2016 fourth quarter.

Risks Related to Financing

DEBT FINANCING

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

The Company’s unsecured subordinated convertible debentures, with an aggregate principal amount of $126.5 million and coupon rate of 6.00% (the “2019 Debentures”), mature on September 30, 2019, and require Extendicare to either repay them in full or refinance them through the capital markets. Management continues to closely monitor the financial markets and believes that the Company has the full financial capacity and ability to execute a plan to complete the refinancing of the 2019 Debentures. Although management has the confidence to complete the refinancing of the 2019 Debentures, there can be no assurance given that the Company will succeed in the refinancing prior to their maturity.

Extendicare's RBC Credit Facility is a demand facility in the amount of $47.3 million that is secured by 13 Class C graded LTC centres in Ontario and is guaranteed by certain Canadian subsidiaries of the Company. As at December 31, 2017, Extendicare had letters of credit totalling $43.8 million issued under the RBC Credit Facility, of which $39.9 million secured our defined benefit pension plan obligations. The RBC Credit Facility has no financial covenants but contains normal and customary terms including annual re-appraisals of the centres that could limit the maximum level of the line of credit and other restrictions on the Canadian entities making certain payments, investments, loans and guarantees. A demand for repayment of amounts drawn on the line of credit could inhibit the flow of cash dividends by Extendicare until alternative financing is obtained.

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 were unable to obtain additional financing or refinancing when needed or on satisfactory terms, it could have a material adverse effect on the business, results of operations and financial condition of the Company.

DEBT COVENANTS

The Company is in compliance with all of its financial covenants as at December 31, 2017. 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.

INTEREST RATES

The Company has limited the amount of debt that may be subject to changes in interest rates. All of the Company's long-term debt is at fixed rates, other than its constructions loans that had an aggregate balance of $29.9 million drawn as at December 31, 2017. The Company primarily finances its senior care and living centres through fixed-rate mortgages and considers securing interest rate swap agreements for any variable-rate debt. The variable-rate Retirement Mortgages and CIBC Term Loan aggregating $85.6 million as at December 31, 2017, have effectively been converted to fixed rate financings with interest rate swaps over the full term. The Company maintains risk management control systems to monitor interest rate risk attributable to its outstanding or forecasted debt obligations as well as any offsetting hedge positions. The Company does not enter into financial instruments for trading or speculative purposes.

Risks Related to 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, results of operations and financial condition of the Company.

Extendicare owns, or operates under finance lease arrangements whereby ownership transfers at the end of the lease term, 100% of its senior care and living centres, excluding those centres operated under management contracts. Senior care and living centres are limited in terms of alternative uses; therefore, their values are directly driven by the cash flow from operations. All but eight of the sixty-six properties owned by Extendicare as at December 31, 2017, are government-funded senior care centres. The value of the real property depends, in part, on government funding and reimbursement programs. In addition, overbuilding in any of the market areas in which the Company owns or operates senior care and living centres could cause these centres to experience decreased occupancy or depressed margins, which could have a material adverse effect on the business, results of operations and financial condition of the Company. Moreover, certain significant expenditures relating to real property ownership, such as real estate taxes, maintenance costs and mortgage payments, represent liabilities that must be met regardless of whether the property is producing any income.

Real property investments are relatively illiquid, thereby limiting the ability of the Company to vary its portfolio in a timely manner in response to changed economic or investment conditions. By specializing in long-term care and retirement living centres, the Company is exposed to adverse effects on these segments of the real estate market. There is a risk that the Company would not be able to sell its real property investments or that it may realize sale proceeds below their current carrying value.

CAPITAL INTENSIVE INDUSTRY

The Company must commit a substantial portion of its funds to maintain and enhance its senior care and living centres and equipment to meet regulatory standards, operate efficiently and remain competitive in its markets. During 2017, the company spent $8.8 million in maintenance capex from continuing operations, and expects to spend in the range of $9 million to $10 million in 2018 to sustain and upgrade its existing centres. In addition to recurring maintenance capex, the Company invests in enhancements at existing centres aimed at earnings growth and improved profitability. These, as well as other future capital requirements, could have a material adverse effect on the business, results of operations and financial condition of the Company.

ENVIRONMENTAL LIABILITIES

As an owner of interests in real property, the Company is subject to government laws and regulations relating to environmental matters. The Company may become liable for the costs of removal or remediation of certain hazardous, toxic, or regulated substances present at, released on or disposed of from, its properties, regardless of whether or not the Company knew of, or was responsible for, their presence, release or disposal. The failure to remove, remediate, or otherwise address such substances, if any, may adversely affect the ability to sell such properties or to borrow using such properties as collateral and could potentially result in claims by public or private parties, including by way of civil action.

Management has determined that future costs could be incurred for possible asbestos remediation of the Company's pre-1980 constructed centres. Although asbestos is currently not a health hazard in any of these centres, 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. Based upon current assumptions, the estimated fair value of the decommissioning provision related to the asbestos remediation was approximately $11 million undiscounted, or $9.2 million discounted, as at December 31, 2017, refer to *note 11* of the audited consolidated financial statements.

In addition, environmental laws may change and the Company may become subject to more stringent environmental laws in the future. Compliance with more stringent environmental laws, which may be more rigorously enforced, could have a material adverse effect on the business, results of operations and financial condition of the Company.

Risks Related to Dependence on Key Personnel

The success of the Company depends, to a significant extent, on the efforts and abilities of its executive officers and other members of management, as well as its ability to attract and retain qualified personnel to manage existing operations and future growth. Although the Company has entered into employment agreements with certain of its key employees, it cannot be certain that any of these individuals will not voluntarily terminate his or her employment with the Company. The loss of an executive officer or other key employee could negatively affect the Company's ability to develop and pursue its business strategy, which could have a material adverse effect on the business, results of operations and financial condition of the Company.

Risks Related to Privacy of Client Information and Cyber Security

As a custodian of a large amount of personal information, including health information, relating to its clients and employees, Extendicare is exposed to the potential loss, misuse or theft of any such information. If the Company was found to be in violation of the federal and provincial 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. In addition, cyber attacks against large organization are increasing in sophistication and are often focused on financial fraud, compromising sensitive data for inappropriate use or disrupting business operations. Extendicare mitigates this risk by deploying appropriate information technology systems, including controls around logical access, physical access and data management, and training its employees relating to safeguarding of sensitive information.

Extendicare has deployed operational technology solutions enabling process automation, electronic health record data collection and automated business intelligence. Technology deployments also present security and privacy risks that must be managed proactively and effectively to prevent breaches that can have an adverse impact on Extendicare's reputation and results of operations. To counter internet-based and internal security threats, Extendicare also deploys leading edge solutions to identify risks to its network, software and hardware systems. Extendicare partners with leading technology security firms to mitigate identified risks and develop contingency plans. As security threats to Extendicare's financial, client and employee data increase and evolve, the Company adjusts and adopts new counter-measures in an effort to ensure it maintains high privacy and security standards.

Although to date the Company has not experienced any material losses relating to cyber attacks or other information security breaches, there can be no assurance that the Company will not incur such losses in the future. The Company's risk and exposure to these matters cannot be fully mitigated because of, among other things, the evolving nature of these threats. As cyber threats continue to evolve, the Company may be required to expend additional resources to continue to modify or enhance protective measures or to investigate and remediate any security vulnerabilities.

ACCOUNTING POLICIES AND ESTIMATES

Critical Accounting Policies and Estimates

A full discussion of Extendicare's critical accounting policies and estimates is provided in *note 3* of the audited consolidated financial statements for the year ended December 31, 2017, and under the heading "Future Changes in Accounting Policies" that follows this section.

Management considers an understanding of Extendicare's accounting policies to be essential to an understanding of its financial statements because their application requires significant judgement and reliance on estimations of matters that are inherently uncertain, which affect the application of the accounting policies and reported amounts. Estimates and underlying assumptions are reviewed on an ongoing basis giving consideration to past experience and other factors that management believes are reasonable under the circumstances. Accordingly, actual results could differ from those estimated. The estimates and assumptions, which have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities, are discussed below.

VALUATION OF PURCHASE PRICE COMPONENTS FOR ACQUISITIONS

Fair value is the price that would be received when selling an asset, or paid when transferring a liability in an orderly transaction (that is other than in a forced or liquidation sale) between market participants at the measurement date under current market conditions. The fair value measurement is based on the presumption that the transaction takes place either: in the principal market for the asset or liability; or in the absence of a principal market, in the most advantageous market for the asset or liability. The principal or the most advantageous market must be accessible by the Company.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability assuming that market participants act in their economic best interests. The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs. The techniques used to estimate future cash flows will vary from one situation to another depending on the circumstances surrounding the asset or liability in question. Management assesses fair value based on estimated discounted cash flow projections and available market information (including the historical operating results and anticipated trends, local markets and economic conditions).

As discussed below under the heading "Valuation of Cash Generating Units and Impairment", an impairment loss is recognized when the carrying amount of an asset is not recoverable. The impairment loss is determined as the excess of the carrying value over its estimated recoverable amount.

Intangible assets with indefinite lives are also required to be assessed at a minimum annually, comparing the estimated recoverable amount to the carrying value to determine if an impairment loss is required to be recognized.

VALUATION OF DEFERRED CONSIDERATION

As part of the proceeds from the U.S. Sale Transaction, the Company was entitled to receive an ongoing cash stream for a period of 15 years relating to certain U.S. skilled nursing centres that were leased prior to the closing. The present value ascribed to these proceeds was reflected as deferred consideration, and was recorded at amortized cost using the effective interest method. As a result of events and discussions that transpired during 2017, the Company does not expect to receive any further amounts in respect of this deferred consideration, and has written off the balance of US$27.9 million, resulting in a charge of $37.5 million in the 2017 second quarter, refer to *note 22* of the audited consolidated financial statements.

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. Property, plant and equipment represents approximately 51% of our total assets as at December 31, 2017, and goodwill and other intangibles represent approximately 10%. 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 centre as a CGU.

Goodwill and indefinite-life intangibles are tested annually, except in the year of acquisition, and other assets are assessed for impairment when indicators of impairment exist. If any such indication exists, then the asset's recoverable amount is reassessed. 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.

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 any impairment loss are based upon information that is known at the time, along with future outlook. When impairment tests are performed, the estimated useful lives of the assets are reassessed, with any change accounted for prospectively. Actual results can differ from these estimates, and can have either a positive or negative impact on the estimate, and impact whether an impairment situation exists.

In 2017, we performed the impairment assessment of our Canadian operations and determined there was no impairment, compared to a net pre-tax impairment loss of $1.7 million recognized in 2016 on goodwill for certain properties. Also during 2016, the carrying value of the assets of the discontinued U.S. IT Hosting business was assessed for impairment based on the expected proceeds, resulting in a pre-tax impairment loss of $9.2 million. There was no impairment of the property and equipment of our continuing operations in 2017 and 2016.

VALUATION OF INDEMNIFICATION PROVISIONS

As a result of the U.S. Sale Transaction, the Company has indemnified certain obligations of its former U.S. operations related to tax, a corporate integrity agreement, and other items. As at December 31, 2017, the remaining provisions totalled $22.7 million or US$18.0 million (2016 – $28.4 million or US$21.2 million). In addition, the Company had an indemnification receivable of $2.8 million (2016 – $8.3 million) as at December 31, 2017. The estimates of these items are assessed every reporting period based on management's best estimate of the ultimate costs or recovery of such items, and any changes to the estimates are reflected as part of other expense in the results of discontinued operations. During 2017, unfavourable changes to the indemnifications totalled $4.8 million (2016 – favourable changes of $6.5 million), refer to *note 22* of the audited consolidated financial statements. 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.

SELF-INSURED LIABILITIES OF DISCONTINUED OPERATIONS

The obligation to settle any U.S. self-insured general and professional liability claims relating to the period prior to the closing of the U.S. Sale Transaction in July 2015, including claims incurred but yet to be reported, remains with Extendicare, which it intends to fund through the Captive. The accrual for U.S. self-insured liabilities of our former U.S. operations 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 expense to fluctuate significantly from one reporting period to

another. Differences between the ultimate claims costs and our historical expense for loss and actuarial assumptions and estimates could have a material adverse effect on our business, results of operations and financial condition.

At December 31, 2017, the accrual for self-insured general and professional liabilities was $61.1 million or US$48.6 million (2016 – $94.8 million or US$70.6 million). Investments held by the Captive to support these accruals totalled $86.3 million (US$68.6 million) as at December 31, 2017. 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 U.S. self-insured liabilities at December 31, 2017, would have impacted our net earnings from discontinued operations by approximately $0.6 million (US$0.5 million). For further information refer to the discussion under the heading "Liquidity and Capital Resources – Accrual for U.S. Self-Insured Liabilities".

TAX UNCERTAINTIES

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

DEFERRED TAX ASSETS AND LIABILITIES

The Company uses the asset and liability method of accounting for deferred income taxes, 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 the substantively enacted tax rates 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. As at December 31, 2017, the Company had recognized deferred tax assets totalling $13.9 million (2016 – $15.3 million). Management believes that it is more likely than not that the Company will realize the benefits of these deductible differences. In addition, as at December 31, 2017, there were capital losses available for Canadian income tax purposes of $16.5 million (2016 – $13.8 million) that have not been tax benefited and are available indefinitely to apply against future capital gains.

New Accounting Policies Adopted

The following new standards were adopted effective January 1, 2017, and have been applied in preparing the financial results for the year ended December 31, 2017. These accounting standards are summarized below, and are more fully described in *note 4* of the audited consolidated financial statements.

CLASSIFICATION AND MEASUREMENT OF SHARE-BASED PAYMENT TRANSACTIONS

Amendments to IFRS 2 "Share-based Payment" address three classification and measurement issues. The Company has adopted these amendments, which: (1) clarify measurement basis for cash-settled share-based payments such that the ultimate amount of expense recorded is equal to the cash settlement that is paid at vesting; (2) clarify the accounting for modifications that change an award from cash-settled to equity-settled; and (3) introduce a requirement that an equity-settled award, with a net settlement feature for withholding tax obligations, be treated as it was wholly equity-settled. The adoption of these amendments did not have a material impact on the Company's consolidated financial statements.

RECOGNITION OF DEFERRED TAX ASSETS FOR UNREALIZED LOSSES

Amendments to IAS 12 "Recognition of Deferred Tax Assets for Unrealized Losses" clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments also clarify the methodology to determine the future taxable profits used for assessing the utilization of deductible temporary differences. In particular, these requirements relate to the recognition of deferred tax assets for unrealized losses on debt instruments measured at fair value. The adoption of the amendments to IAS 12 did not have any impact on the consolidated financial statements.

Future Changes in Accounting Policies

The following new standards, amendments to standards and interpretations, are effective for future annual periods, and have not been applied in preparing the financial results for the year ended December 31, 2017. These accounting standards are summarized below, and are more fully described in *note 5* of the audited consolidated financial statements.

REVENUE RECOGNITION

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers". The new standard provides a single model and two approaches to recognizing revenue: at a point in time or over time. IFRS 15 also includes additional disclosure requirements for revenue accounted for under the standard. The standard applies to contracts with customers, excluding contracts within the scope of the standard on leases. IFRS 15 becomes effective for annual periods beginning on or after January 1, 2018, and is to be applied retrospectively.

The Company has substantially completed its assessment of the potential impact of IFRS 15, and does not expect that it will have any material impact on the amount or timing of revenue recognized in the consolidated financial statements on an annual basis. Additional disclosure requirements may result in respect of revenue for service components of a lease versus the revenue earned under IFRS 16.

FINANCIAL INSTRUMENTS

In July 2014, the IASB issued IFRS 9 "Financial Instruments" (IFRS 9), which addresses the classification, measurement (including impairment) and recognition of financial assets and financial liabilities. The standard is effective for annual periods beginning on or after January 1, 2018, and is to be applied retrospectively.

Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows which effectively measures the asset at either fair value or amortized cost. IFRS 9 replaces the current "incurred loss" impairment model with a new "expected credit loss" model.

The standard largely retains the existing accounting requirements for financial liabilities and the accounting treatment of fair value changes attributable to changes in an entity's own credit risk of financial liabilities that are designated as fair value through profit and loss (FVTPL). The Company does not currently have any financial liabilities classified as FVTPL. IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management. The Company does not currently apply hedge accounting in its consolidated financial statements.

The Company is completing its evaluation of the impact on its financial instruments of the adoption of IFRS 9. The key areas that are in scope of IFRS 9 include: accounts receivable, available-for-sale assets included in investments held for self-insured liabilities and related accumulated other comprehensive income in shareholders' equity. The Company is still in the process of finalizing its assessment of the adoption of IFRS 9; however, it does not expect there to be any material impact relating to the classification and measurement of these assets on its consolidated financial statements.

LEASES

In January 2016, the IASB published IFRS 16 “Leases”. The new standard requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value, using a single model, thereby eliminating the distinction between operating and finance leases. As a lessee, the Company will recognize new assets and liabilities for its operating leases. In addition, the nature and timing of expenses related to those leases will change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of-use assets and interest expense on lease liabilities. IFRS 16 is effective for periods beginning on or after January 1, 2019, with earlier adoption permitted if IFRS 15 “Revenue from Contracts with Customers” has also been applied. The Company does not plan to early adopt IFRS 16, and is in the process of performing its initial assessment of the potential impact of this standard on its consolidated financial statements. The Company expects to disclose additional detailed information, including its transition method, any practical expedients elected and estimated quantitative financial effects, prior to the adoption of IFRS 16.

Disclosure Controls and Procedures

Management is responsible for establishing and maintaining a system of disclosure controls and procedures (DC&P) to provide reasonable assurance that all material information relating to the Company is gathered and reported to senior management, including the Chief Executive Officer (CEO) and 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, 2017, by management under the supervision of the Company’s CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures, as defined by National Instrument 52-109, *Certification of Disclosures in Issuers’ Annual and Interim Filings*, were effective as at December 31, 2017.

Internal Control over Financial Reporting

Management is also responsible for establishing and maintaining adequate internal controls over financial reporting (ICFR) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial reports for external purposes in accordance with IFRS.

Management, under the supervision of the Company’s CEO and CFO, has evaluated the effectiveness of our ICFR using the 2013 Integrated Control framework as published by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that our ICFR were effective and that there were no material weaknesses in our ICFR as at December 31, 2017.

In designing such controls, it should be recognized that due to inherent limitations, any controls, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and may not prevent or detect misstatements. Additionally, management is required to use judgement in evaluating controls and procedures.