EXTENDICARE®
... helping people live better

ENRICHING LIVES
EMBRACING CHANGE

Shareholders' Quarterly Report
Three Months Ended March 31, 2018

Dated: May 10, 2018

50 SINCE 1968 YEARS OF HELPING PEOPLE LIVE BETTER

... helping people live better

MANAGEMENT'S DISCUSSION AND ANALYSIS

Three Months Ended March 31, 2018

Dated: May 10, 2018

YEARS OF HELPING PEOPLE LIVE BETTER

Management's Discussion and Analysis

May 10, 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 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.

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 three months ended March 31, 2018. This MD&A should be read in conjunction with Extendicare's unaudited interim condensed consolidated financial statements for the three months ended March 31, 2018, and the notes thereto, together with the annual MD&A and the audited consolidated financial statements for the year ended 2017, and the notes thereto, prepared in accordance with International Financial Reporting Standards (IFRS), found in Extendicare's 2017 Annual Report. The accompanying unaudited interim condensed consolidated financial statements for the three months ended March 31, 2018, including the notes thereto, have been prepared in accordance with International Accounting Standard (IAS) 34 "Interim Financial Reporting", as issued by the International Accounting Standards Board (IASB). The annual and interim MD&A, financial statements and notes thereto 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 May 10, 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 2017 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 Quarterly 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 the expected annual revenue, net operating income yield (NOI Yield) to be derived from development projects and adjusted funds from operations to be derived from acquisitions and development projects; and statements relating to indemnification provisions and deferred consideration in respect of disposed operations. 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 Quarterly 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 Quarterly 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 measures are not 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 Company's financial statements to assess the Company's operating performance and ability to pay cash dividends; 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 investments”, 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 investments, 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 pay cash dividends 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 “2018 Selected Quarterly Information”, and “2018 First Quarter 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 private-pay retirement operations. 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 2018 EVENTS AND DEVELOPMENTS

This section provides an update on our current activities related to the continued expansion into the Canadian retirement sector and convertible debt refinancing. 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.

As at March 31, 2018, Esprit Lifestyle Communities had eight retirement communities in operation, six of which were acquired since 2015, and two were developed. In the 2016 fourth quarter, we completed the development of Cedar Crossing Retirement Community (Cedar Crossing) in Simcoe, Ontario, and in the 2017 fourth quarter we completed the first phase of Douglas Crossing Retirement Community (Douglas Crossing) in Uxbridge, Ontario.

RETIREMENT ACQUISITIONS

In April 2018, the Company completed the acquisition of 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”).

The Manor is a modern private pay luxury retirement residence with 93 suites offering independent supportive living (ISL) and assisted living (AL) suites. The Village is an enclave of 113-unit townhomes 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 earns a fee equal to 10% of 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.

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 accelerated our expansion plans for this community, and are well under way with the construction of 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, which 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%

ISSUE OF 2025 CONVERTIBLE DEBENTURES AND REDEMPTION OF 2019 CONVERTIBLE DEBENTURES

As previously announced, in April 2018 the Company issued $126.5 million aggregate principal amount of 5.00% convertible unsecured subordinated debentures due April 30, 2025 (the "2025 Debentures"), with a conversion price of $12.25 per Common Share (the "Offering"). The initial offering for $110.0 million of the 2025 Debentures closed on April 17, 2018, and the exercise of the over-allotment option for $16.5 million debentures closed on April 25, 2018.

The net proceeds from the Offering (after deducting the Underwriters' fee and expenses of the Offering), together with cash on hand, was used by the Company to finance the redemption of its outstanding 6.00% convertible unsecured subordinated debentures due September 30, 2019 (the "2019 Debentures"). The redemption price of the 2019 Debentures was equal to the sum of the outstanding aggregate principal amount of $126,500,000 and all accrued and unpaid interest thereon for a total of $127,123,645, or $1,004.93 for each $1,000 principal amount of 2019 Debentures. The notice of the redemption of all of the issued and outstanding 2019 Debentures was issued by the Company on March 26, 2018.

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 the first three months of 2018, approximately 56% of the revenue from our Canadian operations was derived from our long-term care operations, approximately 39% was from our home health care business, approximately 3% was from our retirement living operations, and the balance was from our management, consulting and group purchasing operations.

As at March 31, 2018, Extendicare owned and operated 58 LTC centres, 8 retirement communities, and managed 53 senior care and living centres for third parties. In total, we operated 119 senior care and living centres across four provinces in Canada, with capacity for 15,445 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 11.2 million hours of service annually, based on the trailing twelve months. SGP Purchasing Partner Network provided group purchasing services to third-party clients representing over 45,700 seniors across Canada. In all, as at March 31, 2018, 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 March 31, 2018. Included are nine LTC centres in Ontario that the Company operates under 25-year finance lease arrangements, with full ownership obtained at the end of the lease term.

	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	5,207	4	335	–	–	38	5,542
Alberta	14	1,519	–	–	–	–	14	1,519
Saskatchewan	5	649	4	341	–	–	9	990
Manitoba	5	762	–	–	–	–	5	762
	58	8,137	8	676	–	–	66	8,813
Managed								
Ontario	43	5,581	5	552	1	120	49	6,253
Alberta	1	102	1	109	–	–	2	211
Manitoba	2	168	–	–	–	–	2	168
	46	5,851	6	661	1	120	53	6,632
Total	**104**	**13,988**	**14**	**1,337**	**1**	**120**	**119**	**15,445**

(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 the first three months of 2018 and the 2017 year.

	Three months ended March 31, 2018		Year 2017	
Senior Care Centres	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**
As at beginning of year	**116**	**15,004**	118	15,022
Managed contracts added	**3**	**416**	7	764
Managed contracts ceased	**–**	**–**	(10)	(900)
Retirement communities acquired/developed	**–**	**24**	1	103
Operational capacity adjustments	**–**	**1**	–	15
As at end of period	**119**	**15,445**	116	15,004

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 sale of our U.S. business in 2015 (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 8,137 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 56.3% of consolidated revenue from continuing operations for the first three months of 2018, compared to 56.0% for the same 2017 period (2017 year – 56.2%).

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 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 Alberta Health Services (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 March 31, 2018, 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	1,106	–	–	741	1,847
Class C [(1)]	21	–	476	1,396	1,412	3,284
	34	1,106	476	1,396	2,153	5,131

(1) Beds in operation of 3,284 exclude 3 beds held in abeyance.

RETIREMENT LIVING

Under the Esprit Lifestyle Communities brand, the Company owned and operated eight retirement communities with 676 suites as at March 31, 2018. Four of these communities (341 suites) are located in Saskatchewan and four communities (335 suites) are located in Ontario. Following the acquisition of the Lynde Creek Retirement Community in April 2018, Esprit now has nine retirement communities in operation (769 suites), and a further two new communities and an addition under construction, representing an additional 283 suites.

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 able to choose the living arrangements best suited to their personal preference and needs, as well as the level of care and support they receive as their needs evolve over time. Revenue from these operations represented 2.6% of consolidated revenue from continuing operations for the first three months of 2018, compared to 1.7% for the same 2017 period (2017 year – 1.9%).

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 39.2% of consolidated revenue from continuing operations for the first three months of 2018, compared to 40.1% for the same 2017 period (2017 year – 39.7%).

Provincial governments fund a wide range of home health care services, and contract these services to providers such as ParaMed. For the first three months of 2018, ParaMed received approximately 98% of its revenue from contracts tendered by locally administered provincial agencies (2017 year – 98%), 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 11.2 million hours of service annually, based on the trailing twelve months. For the first three months of 2018, approximately 83% of ParaMed's hours of service were provided in Ontario, 11% 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 divisions, collectively, represented 1.9% of consolidated revenue from continuing operations for the first three months of 2018, compared to 1.6% for the same 2017 period (2017 year – 1.7%).

Management and Consulting Services

Through its Extendicare Assist division, Extendicare leverages its expertise in operating senior care centres in providing a wide range of management and consulting services to third-party owners of senior care and living centres. Extendicare Assist partners with not-for-profit and for-profit organizations, hospitals and municipalities that seek to improve their management practices, quality of care practices and operating efficiencies. Extendicare Assist provides a broad range of services aimed at meeting the needs of its partners, which services can range from operational consulting to overall facility management. The management service offering can include a broad spectrum of services, including: financial administration, record keeping, regulatory compliance and purchasing. In addition, Extendicare Assist provides consulting services to third parties in connection with 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 53 senior care centres with capacity for 6,632 residents as at March 31, 2018 (December 31, 2017 – 50 centres with capacity for 6,216 residents).

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 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 March 31, 2018, SGP provided services to third-party clients, serving approximately 45,700 seniors across Canada (December 31, 2017 – 45,200 seniors). In April 2018, SGP added a client that serves over 4,100 seniors, increasing its network to just under 49,900 seniors.

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 continue 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 March 31, 2018, the accrual for U.S. self-insured general and professional liabilities was $57.5 million (US$44.6 million) compared to $61.1 million (US$48.6 million) at the beginning of the year, and the investments held for U.S. self-insured liabilities totalled $84.9 million (US$65.8 million) compared to $86.3 million (US$68.6 million) at the beginning of the year, with the decline in each reflecting the "run off" of these operations. Since the sale of the U.S. operations in 2015, the Company has released US$19.7 million of the Captive's reserves for self-insured liabilities. 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. 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 one retirement community that opened during 2017 (Douglas Crossing), and two retirement communities that are under development (Bolton and Barrie);

"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 three retirement communities classified as NSS above.

Long-term Care

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

	2018	2017				2016		
Long-term Care Centres	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**
Average Occupancy *(%)*								
Total LTC	**96.4%**	97.7%	98.2%	97.6%	97.2%	97.9%	98.1%	97.9%
Ontario LTC								
Total operations	**97.1%**	98.2%	98.5%	98.2%	97.6%	98.2%	98.6%	98.5%
Preferred Accommodation (1)								
New centres – private	**96.3%**	98.1%	98.3%	98.0%	97.1%	97.2%	96.9%	96.8%
Class C centres – private	**97.4%**	98.8%	97.8%	98.3%	98.5%	97.9%	98.7%	99.2%
Class C centres – semi-private	**65.2%**	66.5%	67.3%	65.7%	64.5%	65.0%	64.8%	64.3%

(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.

The average occupancy at our LTC centres was 96.4% this quarter compared to 97.2% in the 2017 first quarter, and to 97.7% in the 2017 fourth quarter. In terms of the quarterly trends throughout the year, slightly lower occupancy levels are to be expected during the winter months as a result of outbreaks, which can lead to temporary freezes on admissions. In addition, occupancy this quarter was impacted by the fill-up of a 24-bed addition that opened in February at one of our LTC centres, which achieved stabilized occupancy in April 2018.

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 was 96.3% this quarter compared to 97.1% in the 2017 first quarter, and to 98.1% in the 2017 fourth quarter. The average occupancy of the private beds at our Class C centres was 97.4% compared to 98.5% in the 2017 first quarter, and to 98.8% in the 2017 fourth quarter.

Retirement Living

Our retirement living operating segment consists of eight retirement communities in operation, one of which is classified as non same-store having opened in October 2017. 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 2018 and 2017, and as at the end of 2016.

Retirement Communities	**2018**				**2017**	**2016**
As at Occupancy:	**Mar. 31**	**Dec. 31**	**Sept. 30**	**Jun. 30**	**Mar. 31**	**Dec. 31**
Stabilized communities (Empire/Stonebridge/Riverbend)	**90.2%**	95.9%	95.9%	90.2%	90.7%	93.9%
Lease-up communities	**75.3%**	68.6%	61.3%	50.6%	47.3%	41.5%

The occupancy of the three stabilized communities averaged 90.2% as at March 31, 2018, compared to 95.9% as at December 31, 2017, reflecting higher attrition through the winter months. The occupancy of the five lease-up communities continued to improve to an average of 75.3% as at March 31, 2018, compared to 68.6% as at December 31, 2017.

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 for the past eight quarters. The decline in average occupancy of the stabilized retirement communities to 93.2% in the 2018 first quarter from 95.5% in the 2017 fourth quarter was isolated to one community impacted by higher attrition through the winter months.

	2018				**2017**			**2016**
Retirement Communities	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**
Average Occupancy *(%)* – total	**80.4%**	75.9%	71.9%	66.6%	63.4%	63.0%	61.0%	53.8%
Stabilized communities	**93.2%**	95.5%	92.1%	88.1%	87.6%	87.6%	84.4%	76.9%
Lease-up communities	**73.1%**	63.8%	56.7%	50.6%	45.2%	41.7%	38.5%	31.7%

Home Health Care

Revenue from provincial programs represented approximately 98% of Extendicare's home health care revenue in the first three months of 2018 (2017 year – 98%). ParaMed's average daily hours of service declined this quarter by 3.9% to 30,055 from 31,285 in the 2017 first quarter, and by 1.9% from 30,634 in the 2017 fourth quarter. Approximately 60% of the decline in volumes this quarter over the 2017 first quarter was experienced in Ontario, where the competition for personal support workers (PSWs), and to a lesser extent nurses, has intensified. This has contributed to a capacity shortage in many areas across the province, and impacted our ability to continue to meet the growing demand in services that began in the latter half of 2016. We have taken steps to build the capacity required to not only meet our contractual obligations, but to take advantage of the significant organic growth opportunity that exists in the province today. The balance of the decline this quarter was primarily experienced in British Columbia, largely attributable to fiscal year end provincial funding constraints. For the 2017 year, 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. 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	**2018**				**2017**			**2016**
Service Volumes	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**
Hours of service (000's)	**2,705.0**	**2,818.4**	**2,833.6**	**2,859.1**	**2,815.7**	2,845.8	2,772.0	2,666.4
Hours per day	**30,055**	**30,634**	**30,800**	**31,418**	**31,285**	30,932	30,130	29,302

2018 SELECTED QUARTERLY INFORMATION

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

	2018				2017			2016
(thousands of dollars unless otherwise noted)	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**
Revenue	**271,424**	281,398	273,230	273,845	268,858	276,854	268,096	261,425
Net operating income	**29,322**	35,622	34,729	33,867	31,604	33,754	35,040	34,747
Net operating income margin	***10.8%***	*12.7%*	*12.7%*	*12.4%*	*11.8%*	*12.2%*	*13.1%*	*13.3%*
Adjusted EBITDA	**19,977**	27,555	24,025	24,588	21,429	24,246	25,525	26,647
Adjusted EBITDA margin	***7.4%***	*9.8%*	*8.8%*	*9.0%*	*8.0%*	*8.8%*	*9.5%*	*10.2%*
Earnings from continuing operations	**3,566**	10,301	6,545	9,919	4,947	13,250	9,955	9,695
Loss on sale of U.S. operations, net of taxes	**–**	–	–	–	–	(8,458)	–	–
Earnings (loss) from discontinued operations	**1,265**	3,333	–	(32,913)	–	19,848	(643)	(4,947)
Net earnings (loss)	**4,831**	13,634	6,545	(22,994)	4,947	24,640	9,312	4,748
AFFO (continuing operations)	**14,669**	15,713	15,646	14,448	12,688	13,534	20,832	20,012
per basic share *($)*	**0.166**	0.178	0.176	0.162	0.143	0.152	0.236	0.227
AFFO	**14,669**	15,713	15,646	14,448	12,688	13,366	20,300	19,155
per basic share *($)*	**0.166**	0.178	0.176	0.162	0.143	0.150	0.230	0.217
Maintenance Capex								
Continuing operations	**1,051**	3,271	2,777	1,858	907	5,419	2,825	2,835
Discontinued operations	**–**	–	–	–	–	112	280	232
Cash dividends declared	**10,578**	10,623	10,642	10,666	10,652	10,637	10,619	10,595
per share *($)*	**0.120**	0.120	0.120	0.120	0.120	0.120	0.120	0.120
Weighted Average Number of Shares								
Basic	**88,379**	88,633	88,844	88,938	88,807	88,663	88,495	88,269
Diluted	**99,688**	99,916	100,123	100,244	100,086	99,918	99,739	99,513

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

	2018				2017			2016
(thousands of dollars)	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**
Earnings from continuing operations before income taxes	**5,380**	13,212	9,874	12,763	6,715	13,618	13,169	13,597
Add (Deduct):								
Depreciation and amortization	**7,837**	8,170	7,766	7,911	7,532	8,496	7,783	7,753
Net finance costs	**6,580**	6,173	6,385	3,914	7,182	460	4,573	5,092
Other expense	**180**	–	–	–	–	1,672	–	205
Adjusted EBITDA	**19,977**	27,555	24,025	24,588	21,429	24,246	25,525	26,647
Add (Deduct):								
Administrative costs	**7,718**	6,372	9,058	7,524	8,513	7,843	7,843	6,458
Lease costs	**1,627**	1,695	1,646	1,755	1,662	1,665	1,672	1,642
Net operating income	**29,322**	35,622	34,729	33,867	31,604	33,754	35,040	34,747

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 quarterly.

In addition, we report as separate line items, “other expense”, “fair value adjustments”, and “loss (gain) on foreign exchange and investments”, 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 these items, the results from continuing operations included: “other expense” of $0.2 million in the first quarter of 2018, compared to no such charges during 2017, and compared to $4.0 million for the 2016 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, along with realized gains or losses, as part of “fair value adjustments”; as a result, a gain of $0.3 million was recorded in the 2018 first quarter, compared to a net gain of $2.5 million in the 2017 year (loss of $0.1 million, gain of $1.1 million, a gain of $1.2 million, and a gain of $0.3 million, in each of the quarters, respectively), and compared to a net gain of $1.0 million in the 2016 year (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 in connection with net proceeds and deferred consideration received in respect of the disposed U.S. operations and repatriation of funds from our Captive, in addition, our investments held for U.S. self-insured liabilities are measured at fair value through profit and loss and reflected as part of “loss (gain) on foreign exchange and investments”; as a result of these activities our earnings from continuing operations included: a net loss of $0.2 million in the 2018 first quarter, compared to a net gain of $0.8 million in the 2017 year (loss of $0.4 million , gain of $1.5 million, a loss of $0.7 million, and a gain of $0.4 million, in each of the quarters, respectively), and compared to a net loss of $1.2 million in 2016 (loss of $4.0 million, loss of $0.8 million, gain of $1.3 million and gain of $2.3 million, in each of the quarters, respectively).

Further details on the above can be found under the sections “Significant 2018 Events and Developments”, “Key Performance Indicators”, “Other Significant Developments” and “Update of Regulatory and Funding Changes Affecting Results”.

2018 FIRST QUARTER FINANCIAL REVIEW

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

	Three months ended March 31						
			2018			2017	Total
(thousands of dollars)	Canada	U.S.	Total	Canada	U.S.	Total	Change
Revenue	**271,385**	**39**	**271,424**	267,363	1,495	268,858	2,566
Operating expenses	**242,102**	**–**	**242,102**	237,254	–	237,254	4,848
Net operating income	**29,283**	**39**	**29,322**	30,109	1,495	31,604	(2,282)
Administrative costs	**7,435**	**283**	**7,718**	7,990	523	8,513	(795)
Lease costs	**1,627**	**–**	**1,627**	1,662	–	1,662	(35)
Adjusted EBITDA	**20,221**	**(244)**	**19,977**	20,457	972	21,429	(1,452)
Depreciation and amortization	**7,837**	**–**	**7,837**	7,532	–	7,532	305
Other expense	**180**	**–**	**180**	–	–	–	180
Earnings (loss) before net finance costs and income taxes	**12,204**	**(244)**	**11,960**	12,925	972	13,897	(1,937)
Interest expense (net of capitalized interest)	**7,081**	**–**	**7,081**	6,920	–	6,920	161
Interest revenue	**(1,035)**	**–**	**(1,035)**	(829)	–	(829)	(206)
Accretion	**329**	**335**	**664**	310	343	653	11
Fair value adjustments	**(325)**	**–**	**(325)**	52	–	52	(377)
Loss (gain) on foreign exchange and investments	**(554)**	**749**	**195**	68	318	386	(191)
Net finance costs	**5,496**	**1,084**	**6,580**	6,521	661	7,182	(602)
Earnings (loss) from continuing operations before income taxes	**6,708**	**(1,328)**	**5,380**	6,404	311	6,715	(1,335)
Income tax expense (recovery)							
Current	**583**	**–**	**583**	2,977	–	2,977	(2,394)
Deferred	**1,231**	**–**	**1,231**	(1,124)	(85)	(1,209)	2,440
Total income tax expense (recovery)	**1,814**	**–**	**1,814**	1,853	(85)	1,768	46
Earnings (loss) from continuing operations	**4,894**	**(1,328)**	**3,566**	4,551	396	4,947	(1,381)
Earnings from discontinued operations	**–**	**1,265**	**1,265**	–	–	–	1,265
Net earnings (loss)	**4,894**	**(63)**	**4,831**	4,551	396	4,947	(116)
Earnings (loss) from continuing operations	**4,894**	**(1,328)**	**3,566**	4,551	396	4,947	(1,381)
Add (Deduct) [(1)]**:**							
Fair value adjustments	**(238)**	**–**	**(238)**	38	–	38	(276)
Loss (gain) on foreign exchange and investments	**(579)**	**749**	**170**	79	233	312	(142)
Other expense	**132**	**–**	**132**	–	–	–	132
Earnings (loss) from continuing operations before separately reported items, net of taxes	**4,209**	**(579)**	**3,630**	4,668	629	5,297	(1,667)

(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 March 31						
			2018			2017	Total
(thousands of dollars)	Canada	U.S.	Total	Canada	U.S.	Total	Change
Earnings from continuing operations before income taxes	**6,708**	**(1,328)**	**5,380**	6,404	311	6,715	(1,335)
Add (Deduct):							
Depreciation and amortization	**7,837**	**–**	**7,837**	7,532	–	7,532	305
Net finance costs	**5,496**	**1,084**	**6,580**	6,521	661	7,182	(602)
Other expense	**180**	**–**	**180**	–	–	–	180
Adjusted EBITDA	**20,221**	**(244)**	**19,977**	20,457	972	21,429	(1,452)
Add (Deduct):							
Administrative costs	**7,435**	**283**	**7,718**	7,990	523	8,513	(795)
Lease costs	**1,627**	**–**	**1,627**	1,662	–	1,662	(35)
Net operating income	**29,283**	**39**	**29,322**	30,109	1,495	31,604	(2,282)

The following is an analysis of the consolidated results from operations for the 2018 first quarter in comparison to the 2017 first 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 $2.5 million or 1.0% to $271.4 million in the 2018 first quarter, and was impacted by favourable prior period settlement adjustments of $0.8 million received in the 2017 first quarter. Growth in revenue prior to this item was $3.3 million driven primarily by LTC funding enhancements, expansion of the retirement living operations, enhanced home health care funding of approximately $2.0 million to support recent amendments to Ontario’s *Employment Standards Act, 2000* (ESA), and growth in management and group purchasing services, partially offset by a decline in home health care volumes, and lower investment income from the Captive.

Consolidated Operating Expenses

Consolidated operating expenses from continuing operations increased by $4.8 million or 2.0% to $242.1 million in the 2018 first quarter, and included increased labour costs of approximately $1.4 million due to the timing of Good Friday, which was observed in April last year. Prior to this item, operating expenses were higher by $3.4 million or 1.4% over 2017, driven by, increased costs of resident care, expansion of the retirement living operations, and the impact of legislated amendments to Ontario’s ESA, partially offset by lower home health care volumes. Total labour costs increased by $4.0 million over the 2017 first quarter, and represented 86.5% and 86.6% of operating expenses in the first quarters of 2018 and 2017, respectively, and as a percentage of revenue were 77.1% and 76.4%, respectively.

Consolidated Net Operating Income

Consolidated net operating income from continuing operations declined by $2.3 million or 7.2% to $29.3 million in the 2018 first quarter, and represented 10.8% of revenue compared to 11.8% in the same 2017 quarter. Net operating income from the Canadian operations declined by $0.8 million and as noted above, was unfavourably impacted by the additional statutory holiday this quarter and prior period funding received in the 2017 first quarter. Prior to these items, net operating income from the Canadian operations improved by $1.4 million or 4.7% to $30.7 million, and as a percentage of revenue was 11.3% this quarter compared to 11.0% in the same 2017 period, reflecting LTC funding enhancements, growth of our retirement living, management and group purchasing operations, partially offset by a decline in the contribution from our home health care operations. Net operating income from our U.S. operations reflects investment income from the Captive, which was nominal this quarter compared to the same 2017 period.

Administrative and Lease Costs

Administrative and lease costs from continuing operations declined to $9.3 million in the 2018 first quarter from $10.2 million in the same 2017 period, reflecting lower share-based compensation expense and professional fees.

Consolidated Adjusted EBITDA

Consolidated Adjusted EBITDA from continuing operations declined by $1.4 million or 6.8% to $20.0 million this quarter, and represented 7.4% of revenue compared to 8.0% in the same 2017 period. Adjusted EBITDA from the Canadian operations decreased by $0.2 million, and excluding the aggregate $2.2 million impact of the additional holiday and prior period funding, Adjusted EBITDA improved by $2.0 million, and as a percentage of revenue was 8.0% compared to 7.4% in the same 2017 period. Adjusted EBITDA from the U.S. operations declined by $1.2 million reflecting lower investment income and a reduction in administrative costs.

Net Finance Costs

Net finance costs decreased by $0.6 million to $6.6 million this quarter primarily due to favourable changes in loss (gain) on foreign exchange and investments, and fair value adjustments. The 2018 net loss of $0.4 million included an unrealized loss on the valuation of investments for self-insured liabilities of $0.7 million, partially offset by an unrealized gain on the valuation of interest rate swaps of $0.3 million.

Income Taxes

The consolidated income tax provision this quarter was unchanged at $1.8 million, and represented an effective tax rate of 33.7% this quarter compared to 26.4% in the 2017 first quarter. The increase in the consolidated effective tax rate is primarily due to the proportion of earnings between the taxable and non-taxable entities. The effective tax rate of the Canadian operations was 27.0% this quarter compared to 28.9% in the 2017 first quarter.

Discontinued Operations

The earnings from discontinued operations reported this quarter of $1.3 million related to an adjustment to the discount rate applied to the Captive's accrual for U.S. self-insured liabilities.

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.

Three months ended March 31 *(thousands of dollars)*	**Long-term Care**	**Retirement Living**	**Home Health Care**	**Other Canadian Operations**	**Corporate Canada**	**Total Canada**	**Total U.S.**	**Total**
2018 – Same-store								
Revenue	**152,805**	**5,918**	**106,464**	**5,142**	**3**	**270,332**	**39**	**270,371**
Operating expenses	**136,844**	**4,490**	**97,835**	**2,084**	**–**	**241,253**	**–**	**241,253**
Net operating income	**15,961**	**1,428**	**8,629**	**3,058**	**3**	**29,079**	**39**	**29,118**
Net operating income margin (%)	***10.4%***	***24.1%***	***8.1%***	***59.5%***	***100.0%***	***10.8%***	***100.0%***	***10.8%***
2018 – Non Same-store								
Revenue	**–**	**1,053**	**–**	**–**	**–**	**1,053**	**–**	**1,053**
Operating expenses	**–**	**849**	**–**	**–**	**–**	**849**	**–**	**849**
Net operating income	**–**	**204**	**–**	**–**	**–**	**204**	**–**	**204**
2018 – Total								
Revenue	**152,805**	**6,971**	**106,464**	**5,142**	**3**	**271,385**	**39**	**271,424**
Operating expenses	**136,844**	**5,339**	**97,835**	**2,084**	**–**	**242,102**	**–**	**242,102**
Net operating income	**15,961**	**1,632**	**8,629**	**3,058**	**3**	**29,283**	**39**	**29,322**
Net operating income margin (%)	***10.4%***	***23.4%***	***8.1%***	***59.5%***	***100.0%***	***10.8%***	***100.0%***	***10.8%***
2017 – Same-store								
Revenue	150,610	4,630	107,794	4,325	4	267,363	1,495	268,858
Operating expenses	133,678	4,292	97,136	2,079	–	237,185	–	237,185
Net operating income	16,932	338	10,658	2,246	4	30,178	1,495	31,673
Net operating income margin (%)	*11.2%*	*7.3%*	*9.9%*	*51.9%*	*100.0%*	*11.3%*	*100.0%*	*11.8%*
2017 – Non Same-store								
Revenue	–	–	–	–	–	–	–	–
Operating expenses	–	69	–	–	–	69	–	69
Net operating loss	–	(69)	–	–	–	(69)	–	(69)
2017 – Total								
Revenue	150,610	4,630	107,794	4,325	4	267,363	1,495	268,858
Operating expenses	133,678	4,361	97,136	2,079	–	237,254	–	237,254
Net operating income	16,932	269	10,658	2,246	4	30,109	1,495	31,604
Net operating income margin (%)	*11.2%*	*5.8%*	*9.9%*	*51.9%*	*100.0%*	*11.3%*	*100.0%*	*11.8%*
Change in Total								
Revenue	2,195	2,341	(1,330)	817	(1)	4,022	(1,456)	2,566
Operating expenses	3,166	978	699	5	–	4,848	–	4,848
Net operating income	(971)	1,363	(2,029)	812	(1)	(826)	(1,456)	(2,282)

LONG-TERM CARE OPERATIONS

Net operating income from our long-term care operations was $15.9 million this quarter compared to $16.9 million in the 2017 first quarter. Excluding the impact of the aggregate $1.3 million impact of the timing of Good Friday and favourable prior period revenue settlement adjustments received in the 2017 first quarter, net operating income improved by $0.3 million, and as a percentage of revenue was unchanged at 10.8% in each quarter. Prior to the impact of the prior period funding received in 2017, revenue grew by $3.0 million, or 2.0%, of which approximately $1.5 million related to our Ontario flow-through envelopes, and was therefore directly offset by increased costs of resident care, approximately $0.1 million was from improvements in preferred accommodation, and the balance was from other funding enhancements. Prior to the impact of the timing of Good Friday, operating expenses increased by $2.6 million, or 2.0%, primarily due to higher labour, supply, maintenance, and food costs, partially offset by lower property taxes and utility costs. Total labour costs increased by $2.5 million and represented 82.9% of operating expenses this quarter compared to 83.0% in the same 2017 period.

RETIREMENT LIVING OPERATIONS

Net operating income from our retirement living operations improved by $1.4 million this quarter, reflecting continued improvements across all communities. On a same-store basis, growth in net operating income of $1.1 million was primarily attributable to higher revenue, with the improvement in average occupancy to 82.5% this quarter from 63.4% in the 2017 first quarter.

HOME HEALTH CARE OPERATIONS

Net operating income from our home health care operations declined by $2.0 million or 19.0% to $8.6 million this quarter, and represented 8.1% of revenue compared to 9.9% in the 2017 first quarter. The timing of Good Friday contributed to approximately $0.9 million of the decline, with the balance primarily due to a 3.9% decline in volumes. Total labour costs increased by $0.8 million due to government-funded costs associated with legislated amendments to Ontario's ESA, and the added statutory holiday in the period, and represented 92.9% of operating expenses this quarter compared to 92.7% in the same 2017 quarter. The reduction in home health care volumes was in large part due to an industry-wide capacity shortage of PSWs, and to a lesser extent nurses, which impacted our ability to keep up with demand. Initiatives are under way to improve our recruitment efforts in order to attract and retain care staff. Refer to the discussion under the heading "Key Performance Indicators – Home Health Care".

OTHER CANADIAN OPERATIONS

Net operating income from our management and group purchasing operations increased by $0.8 million this quarter, and represented 59.5% of revenue compared to 51.9% in the 2017 first quarter, due to growth in clients served.

U.S. OPERATIONS

The decline in net operating income from the U.S. operations reflected lower investment income of the Captive.

ADJUSTED FUNDS FROM OPERATIONS

The following table provides a reconciliation of our "net earnings" 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".

(thousands of dollars unless otherwise noted)	Three months ended March 31 2018	2017	Change
Net earnings	**4,831**	4,947	(116)
Add (Deduct):			
Depreciation and amortization	**7,837**	7,532	305
Depreciation for FFEC (maintenance capex) (1)	**(1,910)**	(1,855)	(55)
Other expense of continuing operations	**180**	−	180
Other expense (income) of discontinued operations	**(1,265)**	−	(1,265)
Fair value adjustments	**(325)**	52	(377)
Loss (gain) on foreign exchange and investments	**195**	386	(191)
Current income tax expense (recovery) on other expense, fair value adjustments, and gain/loss on foreign exchange and investments (2)	273	234	39
Deferred income tax expense	**958**	(1,209)	2,167
FFO	**10,774**	10,087	687
Amortization of financing costs	**397**	443	(46)
Accretion costs	**664**	653	11
Non-cash share-based compensation	**434**	264	170
Principal portion of government capital funding	**1,300**	1,230	70
Income support (retirement acquisitions)	**–**	66	(66)
Amounts offset through investments held for self-insured liabilities (3)	**241**	(1,003)	1,244
Additional maintenance capex (1)	**859**	948	(89)
AFFO	**14,669**	12,688	1,981
Per Basic Share *($)*			
FFO	**0.122**	0.114	0.008
AFFO	**0.166**	0.143	0.023
Per Diluted Share *($)*			
FFO	**0.122**	0.114	0.008
AFFO	**0.161**	0.141	0.020
Dividends *($)*			
Declared	**10,578**	10,652	(74)
Declared per share *($)*	**0.120**	0.120	−
Weighted Average Number of Shares *(thousands)*			
Basic	**88,379**	88,807	
Diluted	**99,688**	100,086	
Total maintenance capex (1)	**1,051**	907	144

(1) The aggregate of the line items "depreciation for FFEC" and "additional maintenance capex" 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 from the actual 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, such as fair value adjustments, gains or losses on foreign exchange and investments, and other expense.

(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 2018 First Quarter Financial Review

AFFO improved by $2.0 million to $14.7 million ($0.166 per basic share) in the 2018 first quarter from $12.7 million ($0.143 per basic share) in the same 2017 period, primarily related to lower current income taxes of $2.2 million, partially offset by an increase in maintenance capex. A discussion of the factors impacting net earnings can be found under the heading "2018 First Quarter Financial Review".

Our current income taxes benefitted this quarter from favourable timing differences, and the utilization of tax loss carryforwards. We anticipated our effective tax rate on FFO will be in the range of 17% to 20% for the 2018 year. The determination of FFO includes a deduction for current income tax expense, and does not include deferred income tax expense. As a result, the effective tax rates on our FFO can be impacted by: adjustments to our estimates of annual deferred timing differences, particularly when dealing with cash-based tax items versus accounting accruals; changes in the proportion of earnings between taxable and non-taxable entities; book-to-file adjustments for prior year filings; and the ability to utilize loss carryforwards.

Maintenance capex was $1.0 million this quarter, compared to $0.9 million in the same 2017 period, and compared to $3.3 million in the 2017 fourth quarter, representing 0.4%, 0.3% and 1.2% of revenue, respectively. 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, excluding acquisitions, 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.

	Three months ended March 31	
(thousands of dollars)	**2018**	**2017**
Net cash from operating activities	**10,439**	11,603
Add (Deduct):		
Net change in operating assets and liabilities, including interest, taxes and payments for U.S. self-insured liabilities	**3,467**	1,465
Current income tax on items excluded from AFFO (1)	**273**	234
Depreciation for FFEC (maintenance capex) (2)	**(1,910)**	(1,855)
Additional maintenance capex (2)	**859**	948
Principal portion of government capital funding	**1,300**	1,230
Income support (retirement acquisitions)	**–**	66
Amounts offset through investments held for self-insured liabilities (3)	**241**	(1,003)
AFFO	**14,669**	12,688

(1) Represents current income tax with respect to items that are excluded from the computation of AFFO, such as fair value adjustments, gains or losses on foreign exchange and investments, and other expense.

(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 from the actual 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 2018 Events and Developments" summarizes our current activities related to the continued expansion into the retirement sector and convertible debenture activity. This section provides a summary of other developments that have impacted the financial results or operations of Extendicare for 2018 in comparison to 2017.

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. This addition achieved stabilized occupancy in April 2018, and is anticipated to 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 wrote 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.

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, the issuance of new licenses for LTC beds is infrequent because of the funding implications for the provincial governments, while the issuance of licenses for retirement centres is less restrictive as the funding for these services is generally private-pay. In addition to the license procedure, or in some provinces in place of, LTC operators in Alberta, Manitoba, Ontario and Saskatchewan are required to sign service contracts that incorporate service expectations with the applicable provincial health authority.

Fair Workplaces, Better Jobs Act, 2017

In November 2017, Bill 148, *Fair Workplaces, Better Jobs Act, 2017*, 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 necessitated changes in the manner in which the Company manages its workforce in a number of business areas and could subject the Company to increased unionization.

Financially, the impact of the act on the Company's private-pay businesses has not been significant, and the Company expects 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 government funding will be commensurate with the Company's additional costs to service resulting from such legislative changes or that any such funding will not adversely impact future funding.

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.

Strengthening Quality and Accountability for Patients Act, 2017

Bill 160, *Strengthening Quality and Accountability for Patients Act, 2017* received royal assent in December 2017. The act, 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. The act, 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, the act 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. In addition, as part of a stated commitment to "improve the transparency of public information related to the Long-Term Care Home Quality Inspection Program in Ontario", the Ontario Ministry of Health and Long-term Care (MOHLTC) released information on the performance of every LTC centre in the province in April 2018.

Ontario Redevelopment Program

Extendicare has taken a leadership role in advancing the redevelopment of its 21 Class C LTC centres (3,287 beds) in Ontario under the MOHLTC's enhanced redevelopment program. During 2016 and 2017, we requested approval from the MOHLTC to move ahead with the redevelopment of 16 of our existing Class C centres.

In November 2017, the MOHLTC announced plans for 5,000 new LTC beds by 2022 and 30,000 new beds over the next decade, whether in connection with the redevelopment of an existing LTC centre or the development of a new LTC centre. In February 2018, the MOHLTC 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. With this announcement of new LTC beds, we've modified our plans to include 500 to 600 new beds. In addition to enhancing some of our redevelopment projects, 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.

To date, we have received confirmation from the MOHLTC that the licensing application for two of our LTC centres, one in Ottawa and one in Sudbury, have been approved. We had previously received confirmation that another four applications had advanced past the initial stage of the MOHLTC's review process; however, the advancement of two of those applications is now connected to our request for additional beds. The remainder of our original applications remain in the initial stages of the review process. With regards to requests for new beds, the MOHLTC has thus far confirmed that 158 new beds have been allocated to us, subject to the approval of the respective redevelopment projects. The MOHLTC has indicated that to the extent applications for new beds are not advanced in this round, they will be considered in future CFAs.

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 our redevelopment plans, 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.

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, 2018. These funding enhancements, along with our case mix index and re-indexing adjustments, are estimated to provide Extendicare with additional annual revenue of approximately $2.7 million to offset additional costs for resident care and services within the NPC and PSS flow-through envelopes (April 2017 – $3.4 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, 2018 funding enhancements are scheduled to increase the daily rates for the non flow-through component of the accommodation envelope by $0.91 (1.6%) and by $0.54 (6.0%) for the flow-through food component. Extendicare estimates that this enhanced funding represents additional annual revenue of approximately $2.7 million in total, of which approximately $1.0 million is flow-through funding (2017 – $2.5 million in total, of which $1.0 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 are scheduled to increase effective July 1, 2018, by $0.13 to $8.33 per day for a semi-private room and by $0.29 to $18.74 per day for a private room. For beds that are classified as “New” and “A” beds, the maximum preferred accommodation premiums are scheduled to increase effective July 1, 2018, by $0.19 to $12.49 per day for a semi-private room and by $0.41 to $26.04 per day for a private room. Extendicare has 13 “New” LTC centres in Ontario with 1,847 beds, of which 1,106 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 have been implemented during 2016; 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.

AHS is anticipated to announce the April 1, 2018 funding adjustments for long-term care and designated supportive living providers in late May, incorporating changes to the case mix index, occupancy and a likely inflationary component. Last year, the April 1, 2017 funding changes for fiscal 2017/2018 represented additional annual revenue of approximately $0.9 million. In addition, AHS provided retroactive funding adjustments 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 in the 2017 first quarter, and an increase in ongoing annual revenue of approximately $0.5 million.

Beginning on July 1, 2018, the annual accommodation charge adjustments (the portion paid directly by residents of long-term care and designated supportive living centres) is scheduled to increase by 2.1%, based on inflation as reflected by Alberta’s CPI. Extendicare estimates that the 2.1% increase represents additional revenue of approximately $0.7 million (July 2017 – $0.6 million).

Ontario Home Health Care Funding

Extendicare’s ParaMed Home Health Care division operates in six provinces across Canada, currently providing approximately 11.2 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. The Ontario market currently 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, we believe that ParaMed is well-positioned to take advantage of the significant organic growth opportunity that exists today. In addition, ParaMed is exploring 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 that were expected to begin in the spring of 2018, but have yet to be fully operationalized. 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.

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

The following table summarizes the sources and uses of cash between our continuing and discontinued operations for each of the three months ended March 31, 2018 and 2017.

	Three months ended March 31, 2018			Three months ended March 31, 2017		
(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	**20,411**	−	**20,411**	21,693	−	21,693
Net change in operating assets and liabilities						
Accounts receivable	**2,415**	−	**2,415**	10,798	−	10,798
Other assets	**107**	−	**107**	2,646	−	2,646
Accounts payable and accrued liabilities	**5,597**	−	**5,597**	(7,300)	−	(7,300)
	8,119	−	**8,119**	6,144	−	6,144
Interest, taxes and claims payments						
Interest paid	**(9,071)**	−	**(9,071)**	(8,670)	−	(8,670)
Interest received	**1,040**	−	**1,040**	845	−	845
Income taxes paid	**(5,871)**	−	**(5,871)**	(4,013)	−	(4,013)
Payments for U.S. self-insured liabilities	−	**(4,189)**	**(4,189)**	−	(4,396)	(4,396)
	(13,902)	**(4,189)**	**(18,091)**	(11,838)	(4,396)	(16,234)
Net cash from operating activities	**14,628**	**(4,189)**	**10,439**	15,999	(4,396)	11,603
Net cash from investing activities	**(6,823)**	**4,189**	**(2,634)**	(4,700)	4,396	(304)
Net cash from financing activities	**(18,796)**	−	**(18,796)**	(14,022)	−	(14,022)
Foreign exchange gain (loss) on U.S. cash held	**873**	−	**873**	(305)	−	(305)
Decrease in cash and short-term investments	**(10,118)**	−	**(10,118)**	(3,028)	−	(3,028)
Cash and short-term investments at beginning of year	**128,156**	−	**128,156**	101,582	−	101,582
Cash and short-term investments at end of year	**118,038**	−	**118,038**	98,554	−	98,554
Average U.S./Canadian dollar exchange rate			**1.2647**			1.3238

As at March 31, 2018, Extendicare had cash and short-term investments on hand of $118.0 million reflecting a decrease in cash of $10.1 million from the beginning of the year, primarily related to the purchase of Common Shares for cancellation and growth capital expenditures. Cash flow generated by the operating activities of our continuing operations of $14.6 million was in excess of our cash dividends paid of $9.4 million by $5.2 million, and was used to support our maintenance capital expenditures and principal debt repayments.

Discontinued operations reflect the payment of claims for U.S. self-insured liabilities as a component of net cash from operating activities, which payments are funded by the Captive's investments held for self-insured liabilities. Changes in the Captive's investments are reported as a component of net cash from investing activities, as those invested funds are not included in cash and short-term investments.

Net cash from operating activities of the continuing operations was a source of cash of $14.6 million in the first three months of 2018 compared to $16.0 million in the same 2017 period, primarily due to a decline in investment income of the Captive.

Net cash from investing activities of the continuing operations was a use of cash of $6.8 million in the first three months of 2018 compared to a use of cash of $4.7 million in the same 2017 period, primarily attributable to purchases of property, equipment and other intangible assets, as set out in the table below. 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 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 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.

	Three months ended March 31	
(thousands of dollars)	**2018**	**2017**
Growth capex	**5,960**	3,953
Deduct: capitalized interest	**(298)**	(266)
Growth capex, excluding capitalized interest	**5,662**	3,687
Maintenance capex	**1,051**	907
	6,713	4,594

Net cash from financing activities of the continuing operations was a use of cash of $18.8 million in the first three months of 2018 compared to a use of cash of $14.0 million in the same 2017 period. The 2018 activity included scheduled debt repayments of $5.5 million, cash dividends paid of $9.4 million and Common Shares acquired for cancellation under a normal course issuer bid at a cost of $6.3 million, partially offset by draws on construction financing of $2.5 million. The 2017 activity included scheduled debt repayments of $5.4 million, cash dividends paid of $9.4 million, and other items, partially offset by draws on construction financing of $2.6 million. For information on the change in long-term debt, refer to “Liquidity and Capital Resources – Long-term Debt”.

Capital Structure

SHAREHOLDERS’ EQUITY

The following table summarizes our shareholders’ equity for the three months ended March 31, 2018 and the 2017 year.

(thousands of dollars unless otherwise noted)	**Three months ended March 31, 2018**	**2017**
Shareholders’ Equity		
Common Shares	**488,234**	490,881
Equity portion of convertible debentures	**5,573**	5,573
Contributed surplus	**2,823**	2,437
	496,630	498,891
Accumulated deficit at beginning of year, as previously reported	**(365,084)**	(322,025)
Adoption of new standard on financial instruments	**4,334**	–
Net earnings for the period	**4,831**	2,132
Dividends declared	**(10,578)**	(42,583)
Purchase of Common Shares in excess of book value and other	**(2,358)**	(2,608)
Accumulated deficit at end of period	**(368,855)**	(365,084)
Accumulated other comprehensive income	**(8,925)**	(4,851)
Shareholders’ equity	**118,850**	128,956
U.S./Canadian dollar exchange rate at end of period	**1.2900**	1.2571

Share Information *(thousands)*	**May 9, 2018**	**March 31, 2018**	December 31, 2017
Common Shares (TSX symbol: EXE) (1)	**88,013.7**	**87,968.3**	**88,523.3**

(1) Closing market value per the TSX on May 9, 2018, was $8.03.

The retrospective adoption of the new standard on financial instruments resulted in the reclassification of $4.3 million to the opening accumulated deficit in connection with unrealized gains on the investments held for self-insured liabilities that had been recorded as part of accumulated other comprehensive income as at December 31, 2017. The remaining change in accumulated other comprehensive income was due to an increase in accumulated pension adjustments of $0.4 million, partially offset by a $0.7 million change in foreign currency translation adjustments.

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 the first three months of 2018, the Company declared cash dividends of $10.6 million, or $0.12 per share. The portion distributed in cash was $9.4 million, and $1.2 million was by way of 143,581 Common Shares issued under a dividend reinvestment plan. Net cash from operating activities was $10.5 million and included payments made by the Captive for U.S. self-insured liabilities that were funded by its investments held. 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 $14.7 million in the first three months of 2018, dividends declared of $10.6 million represented a payout ratio of approximately 72%. For further information on our AFFO, refer to the discussion under the heading "Adjusted Funds from Operations".

In the 2017 year, the Company declared cash dividends of $42.6 million, or $0.48 per share. The portion distributed in cash was $37.5 million, and $5.1 million was by way of 535,025 Common Shares issued under a dividend reinvestment plan. Compared to our AFFO of $58.5 million for 2017, dividends declared of $42.6 million represented a payout ratio of approximately 73%.

NORMAL COURSE ISSUER BID

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 May 9, 2018, the Company has acquired and cancelled 703,585 Common Shares under the Bid at an average price of $8.89 per share, for a total cost of $6.3 million.

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.

Long-term Debt

CONTINUITY OF LONG-TERM DEBT

The following table summarizes the changes in the carrying amounts of long-term debt for the three months ended March 31, 2018, and the 2017 year.

(millions of dollars)	**Three months ended March 31, 2018**	**Year 2017**
Long-term debt at beginning of year, prior to financing costs	**541.8**	510.3
Issue of long-term debt		
CIBC Term Loan	–	26.4
Construction loans	**2.5**	17.3
Finance lease obligations	–	8.9
Repayment of long-term debt	**(5.5)**	(22.0)
Accretion of convertible debentures	**0.2**	0.9
	539.0	541.8
Financing costs at end of period	**(5.3)**	(5.7)
Long-term debt at end of period	**533.7**	536.1
Less: current portion	**(186.5)**	(59.7)
	347.2	476.4

Long-term debt totalled $533.7 million as at March 31, 2018, compared with $536.1 million as at December 31, 2017, representing a decrease of $2.4 million, primarily due to scheduled debt repayments partially offset by draws on constructing loans. The current portion of long-term debt of $186.5 million included the $125.0 million carrying amount of the 2019 Debentures that were redeemed by the Company on April 30, 2018 with proceeds from the 2025 Debentures that were issued in April 2018. The long-term debt activity for the 2017 year included the $26.4 million refinancing of $3.6 million of mortgages on nine Alberta LTC centres with a $30.0 million term loan with the Canadian Imperial Bank of Commerce (the "CIBC Term Loan"), draws on the construction loans and an increase in finance lease obligations for customized cloud-based software, partially offset by scheduled debt repayments. Extendicare and its subsidiaries are in compliance with all of their respective financial covenants as at March 31, 2018. Details of the components, terms and conditions of long-term debt are provided in *note 8* of the unaudited interim consolidated financial statements.

CREDIT FACILITIES

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 entire $65.0 million was available and unutilized as at March 31, 2018.

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 March 31, 2018, 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 renewed in May 2018 following an actuarial valuation and was reduced to $38.0 million. 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.

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 $32.4 million. The variable-rate mortgages on the Company's retirement communities and the CIBC Term Loan, aggregating $84.9 million as at March 31, 2018, have effectively been converted to fixed rate financing with interest rate swaps over the full term. As at March 31, 2018, the interest rate swaps were valued as an asset of $3.8 million.

The following table summarizes key metrics of our consolidated long-term debt as at March 31, 2018, and December 31, 2017.

	March 31, 2018	**December 31, 2017**
Weighted average interest rate of long-term debt outstanding	**5.0%**	5.0%
Weighted average term to maturity of long-term debt outstanding	**6.8 yrs**	7.1 yrs
Weighted average term to maturity of long-term debt outstanding, excluding finance lease obligations	**6.4 yrs**	6.7 yrs
Trailing twelve months consolidated net interest coverage ratio (1)	**3.8 X**	3.8 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)	**921,179**	934,281
Accumulated depreciation on property and equipment	**217,873**	214,889
Accumulated amortization on other intangible assets	**13,312**	12,229
GBV	**1,152,364**	1,161,399
Debt (3)	**540,425**	543,446
Debt to GBV	**46.9%**	46.8%

(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 by year of maturity, of the Company's long-term debt obligations as at March 31, 2018.

(millions of dollars)	**2018**	**2019**	**2020**	**2021**	**2022**	**After 2022**	**Total**
Convertible debentures (at face value)	126.5	–	–	–	–	–	**126.5**
Long-term debt	51.4	13.9	58.5	13.5	55.8	132.3	**325.4**
Finance lease obligations	6.6	8.5	9.1	9.6	8.6	46.1	**88.5**
	184.5	22.4	67.6	23.1	64.4	178.4	**540.4**

Future Liquidity and Capital Resources

Extendicare's consolidated cash and short-term investments on hand was $118.0 million as at March 31, 2018, compared with $128.2 million as at the beginning of the year, and excluded restricted cash of $2.4 million, and $84.9 million (US$65.8 million) of investments held by our Captive to support the accrual for U.S. self-insured liabilities of $57.5 million (US$44.6 million). In addition, the Company has $65.0 million available to draw under its ParaMed Credit Facility.

The Company has three unencumbered retirement communities that were acquired in 2015 and 2016 for an aggregate cash purchase price of $60.7 million. In addition, construction financings in the aggregate of up to $50.5 million have been secured on two of the three retirement communities currently under construction, of which $23.4 million was drawn as at March 31, 2018. As at March 31, 2018, the Company had incurred approximately $53.5 million of the estimated $111.5 million of Adjusted Development Costs for these three retirement communities.

In April 2018, the Company completed the acquisition of the Lynde Creek Retirement Community for a cash purchase of $34.5 million, subject to customary closing adjustments. Refer to the "Retirement Acquisitions" heading under the "Significant 2018 Events and Developments – Growth of Retirement Operations" section of this MD&A for further details.

As previously announced, in April 2018, the Company completed the issuance of the 2025 Debentures (aggregate principal amount of $126.5 million) and used the net proceeds, together with cash on hand, to redeem the 2019 Debentures (aggregate principal amount of $126.5 million).

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.

OTHER CONTRACTUAL OBLIGATIONS AND CONTINGENCIES

The table below provides summary information relating to the contractual obligations, other than long-term debt, as at March 31, 2018. 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 $57.5 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	2.5	2.9	1.2	0.9	0.5	0.1	**8.1**
Purchase obligations	34.3	13.6	–	–	–	–	**47.9**
	36.8	16.5	1.2	0.9	0.5	0.1	**56.0**

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 March 31, 2018 was $36.9 million (2017 – $36.6 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 March 31, 2018 (2017 – an actuarial deficit of $2.5 million with plan assets of $5.4 million and accrued benefit obligations of $7.9 million). The accrued benefit obligations of the supplementary plan were $34.4 million as at March 31, 2018 (2017 – $34.1 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 March 31, 2018 (2017 – $39.9 million). This letter of credit renews annually in May based on an actuarial valuation of the pension obligations, and in May 2018 was reduced to $38.0 million. 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 continue 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 2017, which confirmed the adequacy of our reserves.

As at March 31, 2018, the accrual for U.S. self-insured general and professional liabilities was $57.5 million (US$44.6 million) compared to $61.1 million (US$48.6 million) at the beginning of the year. The decline of US$4.0 million reflected claim payments of US$3.3 million and an adjustment to the discount factor of US$1.0 million, partially offset by accretion of the discounted liability.

During the 2017 year, payments for self-insured liabilities were $24.2 million (US$18.6 million) and $5.7 million (US$4.4 million) in reserves were released and reflected in discontinued operations. Since the sale of the U.S. operations in 2015, the Company has released US$19.7 million of the Captive's reserves for self-insured liabilities.

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 March 31, 2018, management estimated that approximately $22.4 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 $84.9 million (US$65.8 million) as at March 31, 2018, compared to $86.3 million (US$68.6 million) at the beginning of the year. Since the sale of the U.S. operations in 2015, 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. 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. As previously disclosed, the Company was made aware that a statement of claim was filed against it in the Superior Court Justice of Ontario in late November 2017, which seeks an order pursuant to the *Class Proceedings Act* (Ontario) certifying the action as a class action. The statement of claim, which was served on Extendicare on April 30, 2018, alleges negligence by the Company in the operation of its long-term care centres and its provision of care to residents, and is seeking $150 million in damages. Management does not believe that the lawsuit or the damages sought have merit. Extendicare intends to vigorously defend itself against the claim 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 would 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.

RISKS AND UNCERTAINTIES

There are certain risks inherent in an investment in securities and activities of Extendicare, which investors should carefully consider before investing in Extendicare. Risks and uncertainties are disclosed in Extendicare's 2017 Annual Information Form and in the Company's 2017 Annual Report. To the extent there have been any changes to those risks factors or uncertainties as of the date of this MD&A, they are discussed under the headings "Significant 2018 Events and Developments", "Other Significant Developments", and "Other Contractual Obligations and Contingencies".

ACCOUNTING POLICIES AND ESTIMATES

Critical Accounting Policies and Estimates

A full discussion of Extendicare's critical accounting policies and estimates was provided in the MD&A and the accompanying notes to the audited consolidated financial statements for the year ended December 31, 2017, contained in the Company's 2017 Annual Report. The disclosures in such report have not materially changed since that report was filed, with the exception of the new accounting policies adopted as described below under the heading "New Accounting Policies Adopted", and to the extent there have been any changes in management's estimates, they are discussed under the headings "Significant 2018 Events and Developments" and "Other Significant Developments".

New Accounting Policies Adopted

The following new standards were adopted effective January 1, 2018, and have been applied in preparing the financial results for the three months ended March 31, 2018. These accounting standards are summarized below, and are more fully described in *note 3* of the unaudited interim consolidated financial statements.

REVENUE RECOGNITION

IFRS 15 "Revenue from Contracts with Customers" 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. Under IFRS 15, revenue is recognized when a customer obtains control of the goods or services. The Company adopted IFRS 15 using the cumulative effect method, which does not require restatement of comparative information. Adoption of the standard did not result in material changes to the timing or measurement of revenue recognition, and therefore, there was no cumulative effect adjustment recorded to accumulated deficit on January 1, 2018. However, under the new standard, accommodation revenue recognized under IAS 17 "Leases" is disclosed separately from services revenue recognized under IFRS 15 (refer to *note 20* of the unaudited interim consolidated financial statements).

FINANCIAL INSTRUMENTS

IFRS 9 "Financial Instruments" (IFRS 9) addresses the recognition, classification and measurement (including impairment) of financial assets and financial liabilities. This standard replaces IAS 39 "Financial Instruments: Recognition and Measurement".

Under IFRS 9, financial assets are classified based on the business model in which they are managed and the characteristics of their contractual cash flows. Financial assets are classified as measured at fair value through profit or loss (FVTPL), fair value through comprehensive income (FVOCI), or amortized cost. The new standard eliminates the previous categories for financial assets held to maturity, loans and receivables and available for sale. There are no changes in the measurement basis of financial assets and liabilities upon adoption of IFRS 9, and therefore, there are no differences in carrying amounts.

In addition, IFRS 9 replaces the current "incurred loss" impairment model with a new "expected credit loss" model, which requires timely recognition of expected credit losses. The Company has elected to use the simplified approach and calculates impairment loss on accounts and notes receivable as lifetime expected credit loss.

The Company adopted this standard retrospectively with no restatement of prior periods. There was no material impact on adoption of the standard with the exception of a reclassification of $4.3 million from opening accumulated other comprehensive income to opening accumulated deficit, as investments held for U.S. self-insured liabilities were classified as FVTPL under IFRS 9. These investments include equity securities as well as money market funds that do not have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding; therefore, they are classified as measured at FVTPL under IFRS 9.

Future Changes in Accounting Policies

The following new standard and interpretation, are effective for future annual periods, and have not been applied in preparing the financial results for the period ended March 31, 2018. These accounting standards are summarized below, and are more fully described in *note 4* of the unaudited interim 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 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.

INCOME TAXES

On June 7, 2017, the IASB issued IFRIC Interpretation 23 “Uncertainty over Income Tax Treatments”. The Interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. The interpretation is applicable for annual periods beginning on or after January 1, 2019. Earlier application is permitted. The Company intends to adopt the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the Interpretation has not yet been determined.

CONSOLIDATED FINANCIAL STATEMENTS AND NOTES

Three Months Ended March 31, 2018

Dated: May 10, 2018

Consolidated Statements of Financial Position
Interim Condensed Consolidated Statements of Financial Position
(unaudited)

(in thousands of Canadian dollars)	*notes*	**March 31, 2018**	December 31, 2017
Assets			
Current assets			
Cash and short-term investments		**118,038**	128,156
Restricted cash		**2,430**	2,300
Accounts receivable		**40,092**	42,491
Income taxes recoverable		**9,309**	7,194
Other assets	*6*	**20,672**	20,634
Total current assets		**190,541**	200,775
Non-current assets			
Property and equipment	*5*	**479,874**	479,968
Goodwill and other intangible assets		**95,168**	95,901
Other assets	*6*	**141,344**	143,746
Deferred tax assets		**14,252**	13,891
Total non-current assets		**730,638**	733,506
Total assets		**921,179**	934,281
Liabilities and Equity			
Current liabilities			
Accounts payable and accrued liabilities		**127,620**	123,420
Income taxes payable		**549**	3,500
Long-term debt	*8*	**186,533**	59,664
Provisions	*7*	**29,842**	29,937
Total current liabilities		**344,544**	216,521
Non-current liabilities			
Long-term debt	*8*	**347,147**	476,404
Provisions	*7*	**59,990**	63,062
Other long-term liabilities	*9*	**35,356**	35,022
Deferred tax liabilities		**15,292**	14,316
Total non-current liabilities		**457,785**	588,804
Total liabilities		**802,329**	805,325
Share capital	*11*	**488,234**	490,881
Equity portion of convertible debentures		**5,573**	5,573
Contributed surplus		**2,823**	2,437
Accumulated deficit		**(368,855)**	(365,084)
Accumulated other comprehensive loss		**(8,925)**	(4,851)
Shareholders' equity		**118,850**	128,956
Total liabilities and equity		**921,179**	934,281

See accompanying notes to unaudited interim condensed consolidated financial statements.

Commitments and contingencies (note 17).

Subsequent events (notes 8, 17 and 21).

Extendicare Inc.

Interim Condensed Consolidated Statements of Earnings

(unaudited)

		Three months ended March 31	
(in thousands of Canadian dollars except for per share amounts)	***notes***	**2018**	2017
CONTINUING OPERATIONS			
Revenue			
Long-term care		**152,805**	150,610
Retirement living		**6,971**	4,630
Home health care		**106,464**	107,794
Management, consulting and other		**5,184**	5,824
Total revenue	*20*	**271,424**	268,858
Operating expenses		**242,102**	237,254
Administrative costs		**7,718**	8,513
Lease costs		**1,627**	1,662
Total expenses	*12*	**251,447**	247,429
Earnings before depreciation, amortization, and other expense		**19,977**	21,429
Depreciation and amortization		**7,837**	7,532
Other expense	*13*	**180**	-
Earnings before net finance costs and income taxes		**11,960**	13,897
Interest expense		**7,081**	6,920
Accretion		**664**	653
Loss on foreign exchange and investments	*14*	**195**	386
Interest revenue		**(1,035)**	(829)
Fair value adjustments	*14*	**(325)**	52
Net finance costs		**6,580**	7,182
Earnings before income taxes		**5,380**	6,715
Income tax expense (recovery)			
Current		**583**	2,977
Deferred		**1,231**	(1,209)
Total income tax expense		**1,814**	1,768
Earnings from continuing operations		**3,566**	4,947
DISCONTINUED OPERATIONS			
Earnings from discontinued operations, net of income taxes	*16*	**1,265**	-
Net earnings		**4,831**	4,947
Basic and Diluted Earnings per Share			
Earnings from continuing operations	*15*	**0.04**	0.06
Net earnings	*15*	**0.05**	0.06

See accompanying notes to unaudited interim condensed consolidated financial statements.

Extendicare Inc.

Interim Condensed Consolidated Statements of Comprehensive Income

(unaudited)

	Three months ended March 31	
(in thousands of Canadian dollars)	**2018**	2017
Net earnings	**4,831**	4,947
Other comprehensive income (loss), net of income taxes		
Items that will not be reclassified to profit or loss:		
Defined benefit plan actuarial gains (losses), net of tax recovery of $152 and expense of $11, respectively, for 2018 and 2017	**(424)**	32
Items that are or may be reclassified subsequently to profit or loss:		
Unrealized gain on available-for-sale securities, net of tax	**-**	1,244
Reclassification of realized gains on available-for-sale securities to earnings, net of tax	**-**	(1,411)
Other net change in foreign currency translation adjustment	**684**	(284)
Total items that are or may be reclassified subsequently to profit or loss	**684**	(451)
Other comprehensive income (loss), net of tax	**260**	(419)
Total comprehensive income	**5,091**	4,528

See accompanying notes to unaudited interim condensed consolidated financial statements.

Extendicare Inc.
Interim Condensed Consolidated Statements of Changes in Equity
(unaudited)

(in thousands of Canadian dollars)	Three months ended March 31			
	2018		2017	
	Number of Shares	***Amount***	*Number of Shares*	*Amount*
Share Capital				
Balance at January 1	***88,523,290***	**490,881**	*88,684,485*	489,656
DRIP	***143,581***	**1,212**	*119,259*	1,198
Purchase of shares for cancellation *(note 11)*	***(703,585)***	**(3,903)**	-	-
Share-based compensation	***5,032***	**44**	-	-
Balance at end of period	***87,968,318***	**488,234**	*88,803,744*	490,854
Equity Portion of Convertible Debentures				
Balance at January 1		**5,573**		5,573
Balance at end of period		**5,573**		5,573
Contributed Surplus				
Balance at January 1		**2,437**		941
Share-based compensation		**386**		264
Balance at end of period		**2,823**		1,205
Accumulated Deficit				
Balance at January 1, previously reported		**(365,084)**		(322,025)
Adoption of new standard on financial instruments *(note 3)*		**4,334**		-
Balance at January 1		**(360,750)**		(322,025)
Net earnings		**4,831**		4,947
Dividends declared		**(10,578)**		(10,652)
Purchase of shares for cancellation in excess of book value *(note 11)*		**(2,358)**		-
Other		**-**		(4)
Balance at end of period		**(368,855)**		(327,734)
Accumulated Other Comprehensive Income (Loss)				
Foreign currency translation differences for foreign operations				
Balance at January 1		**678**		3,775
Change in the period		**684**		(284)
Balance at end of period		**1,362**		3,491
Net change in fair value of available-for-sale financial assets, net of tax				
Balance at January 1, previously reported		**4,334**		6,391
Adoption of new standard on financial instruments *(note 3)*		**(4,334)**		-
Balance at January 1		**-**		6,391
Unrealized change in the period		**-**		1,244
Net change reclassified to profit or loss		**-**		(1,411)
Balance at end of period		**-**		6,224
Defined benefit plan actuarial losses, net of tax				
Balance at January 1		**(9,863)**		(9,552)
Change in the period		**(424)**		32
Balance at end of period		**(10,287)**		(9,520)
Accumulated other comprehensive income (loss)		**(8,925)**		195
Shareholders' equity		**118,850**		170,093

See accompanying notes to unaudited interim condensed consolidated financial statements.

Extendicare Inc.

Interim Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands of Canadian dollars)	Three months ended March 31 **2018**	2017
Operating Activities		
Net earnings	**4,831**	4,947
Adjustments for:		
Depreciation and amortization	**7,837**	7,532
Share-based compensation	**434**	264
Deferred taxes	**958**	(1,209)
Current taxes	**856**	2,977
Net finance costs	**6,710**	6,744
Other expense (gains)	**(1,085)**	-
Loss (gain) on foreign exchange, investments and fair value adjustments	**(130)**	438
	20,411	21,693
Net change in operating assets and liabilities		
Accounts receivable	**2,415**	10,798
Other assets	**107**	2,646
Accounts payable and accrued liabilities	**5,597**	(7,300)
	28,530	27,837
Payments for U.S. self-insured liabilities	**(4,189)**	(4,396)
Interest paid	**(9,071)**	(8,670)
Interest received	**1,040**	845
Income taxes paid	**(5,871)**	(4,013)
Net cash from operating activities	**10,439**	11,603
Investing Activities		
Purchase of property, equipment and other intangible assets	**(6,713)**	(4,594)
Decrease in investments held for self-insured liabilities	**2,779**	3,012
Decrease in other assets	**1,300**	1,278
Net cash from investing activities	**(2,634)**	(304)
Financing Activities		
Issue of long-term debt, excluding line of credit	**2,514**	2,580
Repayment of long-term debt, excluding line of credit	**(5,534)**	(5,425)
Increase in restricted cash	**(130)**	(59)
Purchase of securities for cancellation	**(6,258)**	-
Dividends paid	**(9,388)**	(9,449)
Other	**-**	(1,669)
Net cash from financing activities	**(18,796)**	(14,022)
Decrease in cash and short-term investments	**(10,991)**	(2,723)
Cash and short-term investments at beginning of period	**128,156**	101,582
Foreign exchange loss (gain) on cash held in foreign currency	**873**	(305)
Cash and short-term investments at end of period	**118,038**	98,554

See accompanying notes to unaudited interim condensed consolidated financial statements.

Notes to Unaudited Interim Condensed Consolidated Financial Statements
THREE MONTHS ENDED MARCH 31, 2018 AND 2017

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

THREE MONTHS ENDED MARCH 31, 2018 AND 2017
(Tabular amounts in thousands of Canadian dollars, unless otherwise noted)

1. GENERAL INFORMATION AND NATURE OF THE BUSINESS

The common shares (the "Common Shares") of Extendicare Inc. ("Extendicare" or the "Company") are listed on the Toronto Stock Exchange (TSX) under the symbol "EXE". Extendicare and its predecessors have been operating since 1968, providing care and services to seniors throughout Canada. Following the sale 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, management has successfully deployed the sale proceeds to expand and grow the Company's operations across the continuum of seniors' care.

References to "Extendicare", the "Company", "we", "us" and "our" or similar terms refer to Extendicare Inc., either alone, or together with its subsidiaries. The registered office of Extendicare is located at 3000 Steeles Avenue East, Suite 700, Markham, Ontario, Canada, L3R 9W2.

2. BASIS OF PREPARATION

a) Statement of Compliance

These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standards (IAS) 34 "Interim Financial Reporting", as issued by the International Accounting Standards Board (IASB), and were approved by the board of directors of Extendicare Inc. (the "Board") on May 10, 2018.

These interim condensed consolidated financial statements do not include all of the information required for full annual financial statements, and should be read in conjunction with Extendicare Inc.'s 2017 annual consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS). These interim condensed consolidated financial statements follow the same accounting policies and methods of application as the consolidated financial statements as at and for the year ended December 31, 2017, except for those identified in *note 3*.

b) Basis of Measurement

The interim condensed consolidated financial statements have been prepared on the historical cost basis except for financial assets and liabilities classified at fair value through profit or loss.

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

c) Use of Estimates and Judgement

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

Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The more subjective of such estimates are:

-
- determination of the recoverable amount of cash generating units (CGUs) subject to an impairment test;
- valuation of indemnification provisions (*note 7*);
- valuation of self-insured liabilities (*note 7*);
- valuation of financial assets and liabilities (*note 18(b)*);
- valuation of share-based compensation (*note 10*); and
- accounting for tax uncertainties and the tax rates used for valuation of deferred taxes.

In addition, the assessment of contingencies (*note 17*) is subject to judgement.

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

3. NEW ACCOUNTING POLICIES ADOPTED

Effective January 1, 2018, Extendicare adopted the following new standards and amendments to standards issued by the IASB: IFRS 15 "Revenue from Contracts with Customers", and IFRS 9 "Financial Instruments" (IFRS 9), both of which are discussed below.

Revenue Recognition

IFRS 15 "Revenue from Contracts with Customers" 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.

Extendicare adopted IFRS 15 using the cumulative effect method, which does not require restatement of comparative information. Adoption of the standard did not result in material changes to the timing or measurement of revenue recognition, and therefore, there was no cumulative effect adjustment recorded to accumulated deficit on January 1, 2018. However, under the new standard, accommodation revenue recognized under IAS 17 "Leases" is disclosed separately from services revenue recognized under IFRS 15 (*note 20*).

The Company's revised revenue recognition policy is provided below.

Extendicare recognizes revenue upon the transfer of control of goods or services to a customer, in an amount that reflects the consideration expected to be received for those goods or services. The Company generates revenue primarily from the provision of services to residents, rental income, home health care services, and management and consulting services.

(a) LONG-TERM CARE

Services provided to residents include the provision of accommodation and meals, assistance with activities of daily living and continuing care. Programs and services are offered to all residents and specialty programs are offered for those with behavioural needs. Revenue from our long-term care (LTC) segment is regulated by provincial authorities and provincial programs fund a substantial portion of these fees with a co-payment for accommodation being paid by the residents. Accommodation and services are delivered as a bundle and revenue is recognized over time, typically on a monthly basis, which reflects when the services are provided. The frequency that funding is received depends on the jurisdiction in which the LTC centre operates and it varies between a monthly or more frequent basis; and payments from residents are typically due at the beginning of each month.

In some cases, Extendicare's funding is based on occupancy levels achieved or certain policy conditions being met such as spending or staffing hour requirements. In these cases, the Company estimates the amount of funding that it expects to be entitled to for the services provided.

(b) HOME HEALTH CARE

Home health care services provided include complex nursing care, occupational, physical and speech therapy, and assistance with daily activities to accommodate clients living at home. Revenue from the home health care segment is also regulated by provincial authorities. Revenue is derived from both government and private-pay clients. Performance obligations are satisfied as services are delivered and revenue is therefore recognized over time, typically as the services provided to the customer. Private-pay services provided are invoiced at the end of each month based on the services provided, and the billing frequency of government-funded services varies between monthly and bi-weekly depending on the jurisdiction in which we operate.

(c) RETIREMENT LIVING

Retirement living revenue is primarily derived from private-pay residents. Residents are charged monthly fixed fees based on the type of accommodation, level of care and services chosen by the resident, and the location of the retirement community. These fixed fees are allocated to the lease and the service components. Payments are due at the beginning of each month.

Accommodation revenue is recognized on a straight-line basis over the lease term, beginning when a resident has the right to use the retirement community. Revenue allocated to the services is recognized over time, typically on a monthly basis, as this corresponds to the period in which services are provided. Extendicare may also provide additional services to residents on an as-requested basis, at rates established by the Company based upon market conditions. Revenue for such services is recognized as the services are provided to the residents.

(d) OTHER SERVICES

Extendicare also offers management, consulting, group purchasing, accounting and administrative services to third parties in Canada. Rates are set by the contracts, and these contracts are typically accounted for as a single performance obligation because goods or services are delivered concurrently. Revenue is recognized over time, typically on a monthly basis, which reflects when the services are provided.

Financial Instruments

IFRS 9 “Financial Instruments” (IFRS 9) addresses the recognition, classification and measurement (including impairment) of financial assets and financial liabilities. This standard replaces IAS 39 “Financial Instruments: Recognition and Measurement”.

Under IFRS 9, financial assets are classified based on the business model in which they are managed and the characteristics of their contractual cash flows. Financial assets are classified as measured at fair value through profit and loss (FVTPL), fair value through other comprehensive income (FVOCI), or amortized cost; the new standard eliminates the previous categories for financial assets of held to maturity, loans and receivables and available for sale.

In addition, IFRS 9 replaces the current “incurred loss” impairment model with a new “expected credit loss” model, which requires timely recognition of expected credit losses.

The standard largely retains the existing accounting requirements for financial liabilities. However, fair value changes attributable to changes in an entity’s own credit risk are required to be presented in other comprehensive income for financial liabilities that are designated as FVTPL. IFRS 9 also includes a new general hedge accounting standard which aligns hedge accounting more closely with risk management.

The following table summarizes the classification and measurement of financial assets and liabilities upon adoption of IFRS 9. As there are no changes in the measurement basis, there are no differences in carrying amounts.

	Classification prior to January 1, 2018	Measurement prior to January 1, 2018	Classification and Measurement under IFRS 9
Cash and short-term investments	Loans and receivables	Amortized cost	Amortized cost
Restricted cash	Loans and receivables	Amortized cost	Amortized cost
Amounts receivable and other assets	Loans and receivables	Amortized cost	Amortized cost
Investments held for self-insured liabilities	Available for sale	FVOCI	FVTPL
Interest rate swaps	FVTPL	FVTPL	FVTPL
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost	Amortized cost
Long-term debt	Other financial liabilities	Amortized cost	Amortized cost

The Company adopted this standard retrospectively with no restatement of prior periods. There was no material impact on adoption of the standard with the exception of a reclassification of $4.3 million from opening accumulated other comprehensive income to opening accumulated deficit, as investments held for self-insured liabilities were classified as FVTPL under IFRS 9. These investments include equity securities as well as money market funds that do not have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding; therefore, they are classified as measured at FVTPL under IFRS 9.

The Company’s revised accounting policy on financial instruments is provided below.

Financial assets and liabilities classified as measured at amortized cost are initially recognized at fair value (net of any transaction costs) and are subsequently measured at amortized cost using the effective interest method less allowance for credit losses for financial assets.

Financial assets classified as measured at FVOCI are initially recognized at fair value and transaction costs are recognized in net earnings. Subsequently, unrealized gains and losses are recognized in other comprehensive income. Upon derecognition, realized gains and losses are reclassified from other comprehensive income and are recognized in net earnings for debt instruments and remain in other comprehensive income for equity investments. Interest income, foreign exchange gains/losses and impairments from debt instruments as well as dividends from equity investments are recognized in net earnings.

Financial assets and liabilities classified as measured at FVTPL are initially recognized at fair value and transaction costs are recognized in net earnings, along with gains and losses arising from changes in fair value.

A financial asset is classified as amortized cost if it is not designated as at FVTPL, is held within a business model with the purpose of holding assets to collect contractual cash flows; and its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt instrument is classified as FVOCI if is not designated as at FVTPL, is held within a business model with the purpose of holding assets to collect contractual cash flows and selling prior to maturity; and its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets not classified as amortized cost or FVOCI, as described above, are measured at FVTPL, including derivative financial assets.

Financial liabilities are measured as FVTPL if they are classified as held for trading or are designated as such. Other non-derivative financial liabilities are classified as amortized cost. Derivative financial liabilities are classified as FVTPL.

The expected credit loss (ECL) impairment model applies to all financial assets except for investments in equity securities, and to contract assets, lease receivables, loan commitments and financial guarantee contracts.

Loss allowances are measured on either a 12-month ECL basis where ECLs represent possible default events within the 12 months after the reporting date, or a lifetime ECL basis where ECLs represents all possible default events over the expected life of the instrument.

The Company has elected to use the simplified approach and calculates impairment loss on accounts and notes receivable as lifetime expected credit loss. The other ECL models applied to other financial assets also require judgement, assumptions and estimations on changes in credit risks, forecasts of future economic conditions and historical information on the credit quality of the financial asset.

Impairment losses are recorded in operating expenses in the consolidated statement of earnings with the carrying amount of the financial asset reduced through the use of impairment allowance accounts.

4. FUTURE CHANGES IN ACCOUNTING POLICIES

The following new standard and interpretation are effective for future annual periods, and have not been applied in preparing the financial results for the period ended March 31, 2018.

Leases

On January 13, 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. Lessor accounting, however, remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 supersedes IAS 17 “Leases” and related interpretations and 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 IFRS16, and is in the process of performing its 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.

Income Taxes

On June 7, 2017, the IASB issued IFRIC Interpretation 23 “Uncertainty over Income Tax Treatments”. The interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. The Interpretation is applicable for annual periods beginning on or after January 1, 2019. Earlier application is permitted. The Company intends to adopt the Interpretation in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the Interpretation has not yet been determined.

5. PROPERTY AND EQUIPMENT

	March 31, 2018	December 31, 2017
Land and land improvements	**51,008**	51,128
Buildings	**546,789**	544,510
Furniture and equipment	**61,943**	65,088
Leasehold improvements	**2,069**	2,337
Construction in progress	**35,938**	31,794
	697,747	694,857
less: accumulated depreciation	**(217,873)**	(214,889)
	479,874	479,968

During the first three months of 2018, the Company capitalized $0.3 million of borrowing costs related to development projects under construction at an average capitalization rate of 5.6% (2017 – $0.3 million at 6.0%).

6. OTHER ASSETS

	March 31, 2018	December 31, 2017
Investments held for self-insured liabilities	**84,941**	86,296
Amounts receivable and other assets	**73,290**	74,625
Interest rate swaps	**3,785**	3,459
	162,016	164,380
less: current portion	**20,672**	20,634
	141,344	143,746

Investments Held for Self-insured Liabilities

After the sale of our U.S. business in 2015 (the “U.S. Sale Transaction”) (*note 16*), as part of its continuing operations, Extendicare retained its wholly owned Bermuda-based captive insurance company, Laurier Indemnity Company, Ltd. (the “Captive”), which, along with third-party insurers, insured Extendicare’s U.S. general and professional liability risks up to the date of the U.S. Sale Transaction.

Extendicare holds investments within the Captive for self-insured liabilities that are subject to insurance regulatory requirements (*note 7*).

The investment portfolio comprises U.S. dollar-denominated cash of $2.4 million and money market funds of $71.4 million (December 31, 2017 – money market funds of $75.1 million), and investment-grade corporate securities of $11.1 million (December 31, 2017 – $11.2 million). Certain of these investments in the amount of $46.3 million (US$35.9 million) (December 31, 2017 – $45.4 million or US$36.1 million), have been pledged as collateral for letters of credit issued by the banker of the Captive in favour of ceding companies. As at March 31, 2018, all investments were carried at fair value, with changes in fair value reflected in earnings.

Amounts Receivable and Other Assets

Amounts receivable and other assets include discounted amounts receivable due from the government of Ontario with respect to construction funding subsidies for long-term care centres, totalling $57.2 million (December 31, 2017 – $58.5 million) of which $5.3 million (December 31, 2017 – $5.2 million) is current. These subsidies represent funding for a portion of long-term care centre construction costs over a 20-year or 25-year period. The weighted average remaining term of this funding is 15 years.

Also included in amounts receivable and other assets is a $1.8 million receivable as at March 31, 2018 (December 31, 2017 – $2.8 million), resulting from the U.S. Sale Transaction (*note 16*), as well as prepaid expenses and deposits.

Interest Rate Swaps

The interest rate swaps include: (1) the swap contracts on a $30.0 million term loan with the Canadian Imperial Bank of Commerce (the "CIBC Term Loan") secured in May 2017, relating to nine Alberta long-term care centres, to lock in the rate at 3.27% for the full term of five years to May 2022; and (2) the swap contract on $56.3 million non-revolving credit facilities on three retirement communities, with seven-year terms, to lock in the rate at 3.11% for the full terms.

All interest rate swap contracts are measured at fair value through profit or loss, and hedge accounting has not been applied. Changes in fair value are recorded in the statements of earnings (*note 14)*. As at March 31, 2018, the interest rate swaps were valued as an asset of $3.8 million (December 31, 2017 – $3.5 million).

7. PROVISIONS

	March 31, 2018	December 31, 2017
Accrual for self-insured liabilities	**57,515**	61,135
Indemnification provisions	**23,098**	22,679
Decommissioning provisions	**9,219**	9,185
Total provisions	**89,832**	92,999
Less: current portion	**29,842**	29,937
	59,990	63,062

Accrual for 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 (*note 6*) 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.

Within the U.S. long-term care industry, operators are periodically subject to lawsuits alleging negligence, malpractice, or other related claims. The Company retains a portion of the risk within the Captive at a level that the Company believed to be adequate based upon the nature and risks of the business, historical experience and industry standards, along with the type of insurance coverage commercially available in the marketplace.

The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. 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.

As at March 31, 2018, the accrual for self-insured general and professional liabilities was $57.5 million (US$44.6 million) compared to $61.1 million (US$48.6 million) at the beginning of the year. The decline of $3.6 million represented claim payments of $4.1 million (US$3.3 million), and an adjustment of $1.3 million (US$1.0 million) for discounting (*note 16*), partially offset by foreign exchange of $1.5 million, and accretion of $0.3 million (US$0.3 million).

Indemnification Provisions

As a result of the U.S. Sale Transaction (*note 16*), the Company agreed to indemnify certain obligations of the U.S. operations related to tax, a corporate integrity agreement (the "CIA"), and other items. Any revisions to these estimates are reflected as part of other expense in discontinued operations. As at March 31, 2018, the remaining provisions totalled $23.1 million (US$17.9 million) (December 31, 2017 – $22.7 million or US$18.0 million). 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.

Decommissioning Provisions

The decommissioning provisions relate to possible asbestos remediation of Extendicare's pre-1980 constructed centres. An estimated undiscounted cash flow amount of approximately $11 million was discounted using a rate of 1.98% over an estimated time to settle of 8 years. This represents management's best estimate and actual amounts may differ.

8. LONG-TERM DEBT

	Interest rate	Year of Maturity	**March 31, 2018**	December 31, 2017
Convertible unsecured subordinated debentures	6.0%	2019	**125,037**	124,800
CMHC mortgages	2.93% - 7.7%	2018 - 2037	**121,458**	123,911
Non-CMHC mortgages	3.11% - 5.637%	2020 - 2038	**171,566**	172,844
Construction loans	BA + 2.5%	on demand	**32,382**	29,868
Finance lease obligations	2.69% - 7.19%	2018 - 2028	**88,519**	90,323
			538,962	541,746
Less: financing costs			**5,282**	5,678
Total debt, net of financing costs			**533,680**	536,068
Less: current portion			**186,533**	59,664
Long-term debt, net of financing costs			**347,147**	476,404

A summary of significant changes in long-term debt since December 31, 2017, is provided below.

Convertible Unsecured Subordinated Debentures

In 2012, Extendicare issued $126.5 million of aggregate principal amount of 6.00% convertible unsecured subordinated debentures due September 30, 2019, convertible at $11.25 per Common Share (the "2019 Debentures"), with interest payable semi-annually in March and September. These debentures may be redeemed by the Company in whole at any time or in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, on a notice of not more than 60 days and not less than 30 days prior.

On March 26, 2018, the Company issued a notice of intention to redeem the 2019 Debentures, and as a result, they are reflected as a current liability. The redemption was completed on April 30, 2018, and was primarily financed by the proceeds from the issuance of new debentures in April 2018 (*note 21*).

Credit Facilities

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 long-term care centres in Ontario and is guaranteed by certain Canadian subsidiaries of Extendicare. As at March 31, 2018, 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 renewed on May 1, 2018, following an actuarial valuation and was reduced to $38.0 million. The unutilized portion of the credit facility was $3.5 million as at March 31, 2018. 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.

In the fourth quarter of 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 it is available for general corporate purposes of the Company. The ParaMed Credit Facility has no financial covenants, but it does contain normal and customary terms. The entire amount of the credit facility was unutilized as at March 31, 2018.

Construction Loans

Construction financings totalling $51.4 million for three retirement development projects in Simcoe, Bolton, and Uxbridge, were secured in 2016 and provide for additional letter of credit facilities of $500,000, $750,000, and $750,000, respectively, at a rate of 2.5% if utilized. In the 2017 fourth quarter, an additional $9.0 million of construction financing was secured for the Uxbridge expansion. Loan payments are interest-only based on a floating rate of 30-day banker's acceptance (BA) 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: Simcoe, in November 2018 (being 24 months from the issuance of the occupancy permit); Uxbridge, 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. All these financings have been reflected as current. Permanent financing for each of the communities will be sought upon maturity of the construction financing.

As at March 31, 2018, an aggregate of $32.4 million was drawn on the construction loans, and letters of credit totalling $0.5 million were issued under credit facilities.

Finance Lease Obligations

The finance lease obligations outstanding at March 31, 2018 represent finance leases on long-term care centres and the present value of a subscription to customized cloud-based software to be used in the home health care operations. The Company operates nine Ontario long-term care centres, which were built between 2001 and 2003, under 25-year finance lease arrangements. The software balance will be accreted through interest expense, and amortized over the contract term of five years.

Deferred Financing Costs

Deferred financing costs are deducted against long-term debt and are amortized using the effective interest rate method over the term of the debt. The net decrease of $0.4 million in the first three months of 2018 related to the amortization of finance costs.

Below is a summary of the financing costs:

	March 31, 2018	December 31, 2017
Convertible unsecured subordinated debentures	**1,185**	1,387
CMHC mortgages	**2,362**	2,465
Non-CMHC mortgages	**1,513**	1,595
Finance lease obligations	**222**	231
Total financing costs	**5,282**	5,678
Less: current portion	**1,847**	1,463
	3,435	4,215

Interest Rates

The weighted average interest rate of all long-term debt at March 31, 2018, was approximately 5.0% (December 31, 2017 – 5.0%). At March 31, 2018, 94.0% of the long-term debt, including interest rate swaps, was at fixed rates (December 31, 2017 – 94.5%).

9. OTHER LONG-TERM LIABILITIES

	March 31, 2018	December 31, 2017
Accrued pension plan obligation	**34,398**	34,072
Other	**958**	950
	35,356	35,022

10. SHARE-BASED COMPENSATION

The Company's share-based compensation, which includes share appreciation rights (SARs), deferred share units (DSUs) and performance share units (PSUs), was an expense of $0.4 million for the three months ended March 31, 2018 (2017 – expense of $0.8 million).

The carrying amounts of the Company's share-based compensation arrangements are recorded in the consolidated statements of financial position as follows:

	March 31, 2018	December 31, 2017
Accounts payable and accrued liabilities – SARs	**387**	1,146
Contributed surplus – DSUs	**1,406**	1,220
Contributed surplus – PSUs	**1,417**	1,217

Cash-settled Share Appreciation Rights Plan

Prior to the implementation of a new long-term incentive plan in 2016, SARs were granted at the discretion of the Board to directors and eligible employees of Extendicare. As of January 1, 2016, no further awards will be granted under the SARs plan, and those awards that are granted and outstanding will continue to vest pursuant to the SARs plan. SARs issued by the Company are accounted for as cash-settled awards.

A summary of the Company's SARs activity is as follows:

	Three months ended March 31, 2018		Twelve months ended December 31, 2017	
	Share Appreciation Rights	**Weighted Average Vesting Price**	Share Appreciation Rights	Weighted Average Vesting Price
Outstanding, beginning of period	**372,000**	**$7.14**	597,000	$7.05
Vested	**(180,000)**	**6.55**	(216,000)	6.88
Forfeited	**(18,000)**	**7.69**	(9,000)	7.69
Outstanding, end of period	**174,000**	**$7.69**	372,000	$7.14
Average remaining contractural life	**0.2 years**		0.2 years	

The SARs were fair valued using the Black-Scholes model based on the following inputs:

	Three months ended March 31, 2018	Twelve months ended December 31, 2017
Share price	**8.67**	9.11
Volatility	**18.00%**	14.00%
Risk-free interest rate	**1.10%**	1.00% - 1.21%
Strike price	**$7.69**	$6.55 - $7.69
Expected remaining life	**0.2 years**	0.1 years - 0.4 years

Equity-settled Long-term Incentive Plan

The Board implemented a new long-term incentive plan (the "LTIP") in 2016 to provide for a new share-based component of executive and director compensation, which is designed to encourage a greater alignment of the interests of our executives and directors with our shareholders, in the form of PSUs for our employees and DSUs for our non-employee directors. PSUs and DSUs granted under the LTIP will not carry any voting rights. DSUs vest immediately upon grant and PSUs vest three years from the date of grant. During the three months ended March 31, 2018, the Board used its discretion to vest a portion of a participant's PSU account upon cessation of employment, resulting in the issuance from treasury of 5,032 Common Shares. An aggregate of 4,402,860 Common Shares are reserved and available for issuance pursuant to the LTIP.

A summary of the Company's DSU and PSU activity is as follows:

	Deferred Share Units		**Performance Share Units**	
	Three months ended March 31, 2018	Twelve months ended December 31, 2017	**Three months ended March 31, 2018**	Twelve months ended December 31, 2017
Units outstanding, beginning of period	**134,369**	61,124	**342,944**	173,550
Granted	**22,069**	72,742	**192,116**	173,329
Reinvested dividend equivalents	**1,861**	4,137	**4,632**	10,616
Forfeited	**-**	-	**(14,426)**	(14,551)
Settled	**-**	(3,634)	**(5,032)**	-
Units outstanding, end of period	**158,299**	134,369	**520,234**	342,944
Weighted average fair value of units granted during the period at grant date	**$8.46**	$9.68	**$9.33**	$11.63

The grant date values of PSUs awarded were based on the fair values of one award with two equal components being the adjusted funds from operations (AFFO) and total shareholder return (TSR). The fair values of the AFFO component were measured using the previous day's closing trading price of the Common Shares. The fair values of the TSR component were measured using the Monte Carlo simulation method.

A summary of PSUs granted and the assumptions used to determine the grant date values are as follows:

	Three months ended March 31, 2018		Twelve months ended December 31, 2017
Grant date	**March 15, 2018**	March 15, 2017	May 25, 2017
Vesting date	**March 15, 2021**	March 15, 2020	May 25, 2020
PSUs granted	**192,116**	160,689	12,640
Fair value of AFFO component	**$4.36**	$5.24	$5.11
Fair value of TSR component	**4.97**	6.42	6.12
Grant date fair value	**$9.33**	$11.66	$11.23
Expected volatility of Extendicare's Common Shares	**23.66%**	23.09%	24.90%
Expected volatility of the Index	**12.20%**	13.41%	13.60%
Risk-free rate	**1.84%**	0.92%	0.75%
Dividend yield	**nil**	nil	nil

11. SHARE CAPITAL

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.

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 platforms. 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 May 10, 2018, the Company has acquired and cancelled 703,585 Common Shares under the Bid at an average price of $8.89 per share, for a total cost of $6.3 million.

12. EXPENSES BY NATURE

	Three months ended March 31	
	2018	2017
Employee wages and benefits	**214,209**	210,287
Food, drugs, supplies and other variable costs	**11,817**	11,293
Property based and other costs	**23,794**	24,187
Total operating expenses and administrative costs	**249,820**	245,767
Lease costs	**1,627**	1,662
Total expenses	**251,447**	247,429

13. OTHER EXPENSE

Other expense for the 2018 first quarter included costs of $0.2 million related to the April 2018 acquisition of the Lynde Creek Retirement Community (*note 21*).

14. FOREIGN EXCHANGE AND INVESTMENT LOSS (GAIN) AND FAIR VALUE ADJUSTMENTS

Loss and Gain on Foreign Exchange and Investments

Loss (gain) on foreign exchange and investments include: (1) an unrealized foreign exchange loss in 2017 of $0.3 million related to deferred consideration in connection with the U.S. Sale Transaction (*note 16*); (2) a foreign exchange gain of $0.6 million on balances remaining related to the U.S. Sale Transaction that are denominated in U.S. dollars, $0.7 million of which were unrealized (2017 – losses of $0.1 million, most of which were unrealized); and (3) loss on fair value adjustments on investments held for self-insured liabilities of $0.7 million for the 2018 first quarter (2017 – nil) (*note 3*).

Fair Value Adjustments

Fair value adjustments represent interest rate swap contracts to lock in the interest rates for certain mortgages. The fair value of these contracts as at March 31, 2018, resulted in a gain of $0.3 million for the 2018 first quarter (2017 – loss of $0.1 million) (*note 6*).

15. EARNINGS PER SHARE

Basic earnings per share (EPS) is calculated by dividing the net earnings for the period by the weighted average number of shares outstanding during the period, including vested DSUs awarded that have not settled. Diluted EPS is calculated by adjusting the net earnings and the weighted average number of shares outstanding for the effects of all dilutive instruments. The Company's potentially dilutive instruments include the convertible debentures and equity-settled compensation arrangements. The number of shares included with respect to the PSUs is computed using the treasury stock method.

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

	Three months ended March 31	
	2018	2017
Numerator for Basic and Diluted Earnings per Share		
Earnings from continuing operations		
Net earnings for basic earnings per share	**4,831**	4,947
Less: earnings from discontinued operations, net of tax	**1,265**	-
Earnings from continuing operations for basic earnings per share	**3,566**	4,947
Add: after-tax interest on convertible debt	**1,821**	1,764
Add: after-tax loss on fair value adjustment on financial instruments	**763**	-
Earnings from continuing operations for diluted earnings per share	**6,150**	6,711
Net earnings		
Net earnings for basic earnings per share	**4,831**	4,947
Add: after-tax interest on convertible debt	**1,821**	1,764
Add: after-tax loss on fair value adjustment on financial instruments	**763**	-
Net earnings for diluted earnings per share	**7,415**	6,711

	Three months ended March 31	
	2018	2017
Denominator for Basic and Diluted Earnings per Share		
Actual weighted average number of shares	**88,243,066**	88,745,435
Vested equity-settled compensation	**135,540**	61,598
Weighted average number of shares for basic earnings per share	**88,378,606**	88,807,033
Shares issued if all convertible debt was converted	**11,244,444**	11,244,444
Dilutive effect of equity-settled compensation	**65,200**	34,709
Total for diluted earnings per share	**99,688,250**	100,086,186
Basic and Diluted Earnings per Share *(in dollars)*		
Earnings from continuing operations	**0.04**	0.06
Earnings from discontinued operations	**0.01**	-
Net earnings	**0.05**	0.06

16. DISCONTINUED OPERATIONS

U.S. Sale Transaction

In connection with the U.S. Sale Transaction, the Company agreed to indemnify certain obligations of the U.S. operations related to tax, a CIA, and other items. In connection with these items, as at March 31, 2018, the Company had remaining provisions totalling $23.1 million (US$17.9 million) (*note 7*), and a receivable of $1.8 million (US$1.4 million) (*note 6*) (December 31, 2017 – provisions of $22.7 million and receivable of $2.8 million). There have been no changes to the estimates of indemnification provisions and receivables for the first quarters of 2018 and 2017. For the 2018 first quarter, an adjustment to the discount rate applied resulted in a $1.3 million (US$1.0 million) decrease in the accrual for self-insured liabilities (*note 7*).

In October 2014, EHSI completed and executed a settlement agreement with the U.S. Department of Justice (DOJ), the Office of the Inspector General (OIG) of the U.S. Department of Health and Human Services and multiple states. As is standard practice in settlements of OIG and DOJ investigations, EHSI entered into the CIA, with the OIG for a five-year period effective October 3, 2014. Under the terms of the U.S. Sale Transaction, Extendicare has agreed to share in the costs incurred in order to implement and comply with the requirements of the CIA. Though the actual costs for the Purchaser to comply with the CIA are difficult to estimate, the Company has included a provision for such costs in its provision for indemnification obligations (*note 7*).

17. COMMITMENTS AND CONTINGENCIES

Property and Equipment Commitments

Extendicare has outstanding commitments of $47.9 million at March 31, 2018, in connection with private-pay retirement communities under development in Ontario, which will be substantially financed with a combination of construction financing and cash on hand. These are expected to be incurred over the next two years.

Legal Proceedings 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. As previously disclosed, the Company was made aware that a statement of claim was filed against it in the Superior Court Justice of Ontario in late November 2017, which seeks an order pursuant to the *Class Proceedings Act* (Ontario) certifying the action as a class action. The statement of claim, which was served on Extendicare on April 30, 2018, alleges negligence by the Company in the operation of its long-term care centres and its provision of care to residents, and is seeking $150 million in damages. Management does not believe that the lawsuit or the damages sought have merit. Extendicare intends to vigorously defend itself against the claim 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 would 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.

18. FINANCIAL RISK MANAGEMENT

(a) Management of Risks

LIQUIDITY RISK

Liquidity risk is the risk that the Company will encounter difficulty in meeting its contractual obligations. We manage our liquidity risk through the use of budgets and forecasts. Cash requirements are monitored regularly based on actual financial results and actual cash flows to ensure that there are sufficient resources to meet operational requirements. We ensure that there are sufficient funds for declared and payable distributions and any other future commitments at any point in time. In addition, since there is a risk that current borrowings and long-term debt may not be refinanced or may not be refinanced on as favourable terms or with interest rates as favourable as those of the existing debt, we attempt to appropriately structure the timing of contractual long-term debt renewal obligations and exposures. In April 2018, the Company successfully refinanced the 2019 Debentures by issuing a new series of debentures which mature in 2025 (*notes 8 and 21*).

CURRENCY RISK

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Cross-border transactions are subject to exchange rate fluctuations that may result in realized gains or losses as and when payments are made.

As a result of the U.S. Sale Transaction, our exposure to foreign currency risk has been significantly reduced. The following table outlines the net asset exposure to both the U.S. continuing operations and other items retained from the U.S. Sale Transaction as at March 31, 2018 (*note 16*).

(in thousands of US$)	**March 31, 2018**
Assets	
Current assets	**28,559**
Investments held for self-insured liabilities	**65,846**
Liabilities	
Current liabilities	**18,203**
Indemnification provisions	**17,905**
Non-current liabilities	**27,863**
Net asset exposure	**30,434**

INTEREST RATE RISK

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

To mitigate interest rate risk, the Company's long-term care debt portfolio includes fixed-rate debt and variable-rate debt with interest rate swaps in place. At March 31, 2018, construction loans of $32.4 million are variable-rate debt, which do not have interest rate swaps in place. The Company's credit facility, and future borrowings, may be at variable rates which would expose the Company to the risk of interest rate volatility (*note 8*).

Although the majority of the Company's long-term debt is effectively at fixed rates, there can be no assurance that as debt matures, renewal rates will not significantly impact future income and cash flow.

Below is the interest rate profile of our interest-bearing financial instruments, which reflects the impact of the interest rate swaps (*note 6*):

	Carrying Amount	
	March 31, 2018	December 31, 2017
Fixed-rate instruments:		
Long-term debt(1)	**506,580**	511,878
Total liability in fixed-rate instruments	**506,580**	511,878
Variable-rate instruments:		
Long-term debt(1)	**32,382**	29,868
Total liability in variable-rate instruments	**32,382**	29,868

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

Fair Value Sensitivity Analysis for Variable-rate Instruments

All long-term debt with variable rates are classified as other financial liabilities, which are measured at amortized cost using the effective interest method of amortization; therefore, changes in interest rates would not affect OCI with respect to variable-rate debt. As at March 31, 2018, long-term debt with variable rates represented 6.0% of total debt. The value of the interest rate swaps is subject to fluctuations in interest rates, changes in fair value of these swaps are recognized in net earnings (*notes 6 and 14*).

Cash Flow Sensitivity Analysis for Variable-rate Instruments

An increase of 100 basis points in interest rates would have decreased net earnings by $0.1 million and a decrease of 100 basis points in interest rates would have increased net earnings by $0.1 million. This analysis assumes that all other variables, in particular foreign currency rates, remains constant, and excludes variable interest rate debt that is locked in through interest rate swaps.

OTHER RISKS

Other aspects of Extendicare's financial risk management objectives and policies are consistent with those disclosed in the consolidated financial statements as at and for the year ended December 31, 2017.

(b) Fair values of Financial Instruments

As at March 31, 2018	Amortized Cost	Fair Value through Profit and Loss	Total Carrying Amount	Fair Value
Financial assets:				
Cash and short-term investments	**118,038**	**-**	**118,038**	**118,047**
Restricted cash	**2,430**	**-**	**2,430**	**2,430**
Invested assets(1)	**442**	**-**	**442**	**442**
Accounts receivable	**40,092**	**-**	**40,092**	**40,092**
Interest rate swaps	**-**	**3,785**	**3,785**	**3,785**
Amounts receivable and other assets(2) (3)	**57,241**	**-**	**57,241**	**61,065**
Investments held for self-insured liabilities	**2,371**	**82,570**	**84,941**	**84,941**
	220,614	**86,355**	**306,969**	**310,802**
Financial liabilities:				
Accounts payable	**2,423**	**-**	**2,423**	**2,423**
Long-term debt excluding convertible debentures(3) (4)	**413,925**	**-**	**413,925**	**426,929**
Convertible debentures	**125,037**	**-**	**125,037**	**126,816**
	541,385	**-**	**541,385**	**556,168**

As at December 31, 2017	Loans and Receivables	Available for Sale	Fair Value through Profit and Loss	Other Financial Liabilities	Total Carrying Amount	Fair Value
Financial assets:						
Cash and short-term investments	128,156	-	-	-	128,156	128,166
Restricted cash	2,300	-	-	-	2,300	2,300
Invested assets(1)	442	-	-	-	442	442
Accounts receivable	42,491	-	-	-	42,491	42,491
Interest rate swaps	-	-	3,459	-	3,459	3,459
Amounts receivable and other assets(2) (3)	58,541	-	-	-	58,541	62,300
Investments held for self-insured liabilities	-	86,296	-	-	86,296	86,296
	231,930	86,296	3,459	-	321,685	325,454
Financial liabilities:						
Accounts payable	-	-	-	4,272	4,272	4,272
Long-term debt excluding convertible debentures(3)(4)	-	-	-	416,946	416,946	432,259
Convertible debentures	-	-	-	124,800	124,800	129,650
	-	-	-	546,018	546,018	566,181

(1) Included in other assets.

(2) Includes primarily amounts receivable from government.

(3) Includes current portion.

(4) Excludes netting of financing costs.

FAIR VALUE HIERARCHY

We use a fair value hierarchy to categorize the type of valuation techniques from which fair values are derived: Level 1 – use of quoted market prices; Level 2 – internal models using observable market information as inputs; Level 3 – internal models without observable market information as inputs.

The Company uses interest rate swap contracts to effectively fix the interest rate on certain mortgages. As hedge accounting is not applied, the contracts are carried at fair value and reported as assets or liabilities depending on the fair value on the reporting date, with the change in fair value recognized in net earnings. The fair value of the interest rate swap contracts are calculated through discounting future expected cash flows using the BA-based swap curve. Since the BA-based swap curve is an observable input, these financial instruments are considered Level 2.

The fair values of financial instruments presented above, where carrying value is not a reasonable approximation of fair value, are as follows:

	Level 1	Level 2	Level 3	Total
As at March 31, 2018:				
Investments held for self-insured liabilities	**84,941**	**-**	**-**	**84,941**
Amounts receivable and other assets	**-**	**61,065**	**-**	**61,065**
Interest rate swaps	**-**	**3,785**	**-**	**3,785**
Convertible debentures	**126,816**	**-**	**-**	**126,816**
As at December 31, 2017:				
Investments held for self-insured liabilities	86,296	-	-	86,296
Amounts receivable and other assets	-	62,300	-	62,300
Interest rate swaps	-	3,459	-	3,459
Convertible debentures	129,650	-	-	129,650

19. RELATED PARTY TRANSACTIONS

Transactions with Key Management Personnel

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 long-term care 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.

20. SEGMENTED INFORMATION

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". The continuing U.S. operations now consist of the Captive.

The long-term care segment represents the 58 long-term care centres that the Company owns and operates in Canada. The retirement living segment includes six acquired retirement communities, and two communities that were newly constructed and opened in the fourth quarters of 2016 and 2017. The retirement communities provide services to private-pay residents at rates set by Extendicare based on the services provided and market conditions. Through our wholly owned subsidiary ParaMed Inc. (ParaMed), ParaMed's home health care operations provide complex nursing care, occupational, physical and speech therapy, and assistance with daily activities to accommodate those living at home.

The Company's other Canadian operations are composed of its management, consulting and group purchasing operations. Through our Extendicare Assist division, we provide management and consulting services to third-party owners; and through our SGP Purchasing Partner Network division, we offer cost-effective purchasing contracts to other senior care providers for food, capital equipment, furnishings, cleaning and nursing supplies, and office products.

The Company continues to group its former and remaining U.S. operations as one segment. The Captive's expense incurred for self-insured liabilities related to the Company's U.S. general and professional liability risks up to the date of the U.S. Sale Transaction 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.

Intersegment adjustments in the following tables reflect the reversal of intercompany amounts that are eliminated prior to the preparation of the Company's consolidated financial statements.

(in thousands of Canadian dollars)	Long-term Care	Retirement Living	Home Health Care	Other Canadian Operations	Corporate Canada	Total Canada	Total U.S.	Total
								Three months ended March 31, 2018
CONTINUING OPERATIONS								
Revenue								
Long-term care	**152,805**	**-**	**-**	**-**	**-**	**152,805**	**-**	**152,805**
Retirement living	**-**	**6,971**	**-**	**-**	**-**	**6,971**	**-**	**6,971**
Home health care	**-**	**-**	**106,464**	**-**	**-**	**106,464**	**-**	**106,464**
Management, consulting and other	**-**	**-**	**-**	**5,142**	**3**	**5,145**	**39**	**5,184**
Total revenue	**152,805**	**6,971**	**106,464**	**5,142**	**3**	**271,385**	**39**	**271,424**
Operating expenses	**136,844**	**5,339**	**97,835**	**2,084**	**-**	**242,102**	**-**	**242,102**
Administrative costs	**-**	**-**	**-**	**-**	**7,435**	**7,435**	**283**	**7,718**
Lease costs	**-**	**-**	**1,126**	**-**	**501**	**1,627**	**-**	**1,627**
Total expenses	**136,844**	**5,339**	**98,961**	**2,084**	**7,936**	**251,164**	**283**	**251,447**
Earnings (loss) before depreciation, amortization, and other expense	**15,961**	**1,632**	**7,503**	**3,058**	**(7,933)**	**20,221**	**(244)**	**19,977**
Depreciation and amortization	**-**	**-**	**-**	**-**	**7,837**	**7,837**	**-**	**7,837**
Other expense	**-**	**-**	**-**	**-**	**180**	**180**	**-**	**180**
Earnings (loss) before net finance costs and income taxes	**15,961**	**1,632**	**7,503**	**3,058**	**(15,950)**	**12,204**	**(244)**	**11,960**
Interest expense	**-**	**-**	**-**	**-**	**7,081**	**7,081**	**-**	**7,081**
Accretion	**-**	**-**	**-**	**-**	**329**	**329**	**335**	**664**
Loss (gain) on foreign exchange and investments	**-**	**-**	**-**	**-**	**(554)**	**(554)**	**749**	**195**
Interest revenue	**-**	**-**	**-**	**-**	**(1,035)**	**(1,035)**	**-**	**(1,035)**
Fair value adjustments	**-**	**-**	**-**	**-**	**(325)**	**(325)**	**-**	**(325)**
Net finance costs	**-**	**-**	**-**	**-**	**5,496**	**5,496**	**1,084**	**6,580**
Earnings (loss) before income taxes	**15,961**	**1,632**	**7,503**	**3,058**	**(21,446)**	**6,708**	**(1,328)**	**5,380**
Income tax expense								
Current	**-**	**-**	**-**	**-**	**583**	**583**	**-**	**583**
Deferred	**-**	**-**	**-**	**-**	**1,231**	**1,231**	**-**	**1,231**
Total income tax expense	**-**	**-**	**-**	**-**	**1,814**	**1,814**	**-**	**1,814**
Earnings (loss) from continuing operations	**15,961**	**1,632**	**7,503**	**3,058**	**(23,260)**	**4,894**	**(1,328)**	**3,566**
DISCONTINUED OPERATIONS								
Earnings from discontinued operations, net of income taxes	**-**	**-**	**-**	**-**	**-**	**-**	**1,265**	**1,265**
Net earnings (loss)	**15,961**	**1,632**	**7,503**	**3,058**	**(23,260)**	**4,894**	**(63)**	**4,831**

In the 2018 first quarter, Retirement living includes accommodation revenue of approximately $2.9 million and services revenue of approximately $4.1 million.

(in thousands of Canadian dollars)	Long-term Care	Retirement Living	Home Health Care	Other Canadian Operations	Corporate Canada	Total Canada	Total U.S.	Total
								Three months ended March 31, 2017
CONTINUING OPERATIONS								
Revenue								
Long-term care	150,610	-	-	-	-	150,610	-	150,610
Retirement living	-	4,630	-	-	-	4,630	-	4,630
Home health care	-	-	107,794	-	-	107,794	-	107,794
Management, consulting and other	-	-	-	4,325	4	4,329	1,495	5,824
Total revenue	150,610	4,630	107,794	4,325	4	267,363	1,495	268,858
Operating expenses	133,678	4,361	97,136	2,079	-	237,254	-	237,254
Administrative costs	-	-	-	-	7,990	7,990	523	8,513
Lease costs	-	-	1,185	-	477	1,662	-	1,662
Total expenses	133,678	4,361	98,321	2,079	8,467	246,906	523	247,429
Earnings (loss) before depreciation, amortization, and other expense	16,932	269	9,473	2,246	(8,463)	20,457	972	21,429
Depreciation and amortization	-	-	-	-	7,532	7,532	-	7,532
Other expense	-	-	-	-	-	-	-	-
Earnings (loss) before net finance costs and income taxes	16,932	269	9,473	2,246	(15,995)	12,925	972	13,897
Interest expense	-	-	-	-	6,920	6,920	-	6,920
Accretion	-	-	-	-	310	310	343	653
Loss on foreign exchange	-	-	-	-	68	68	318	386
Interest revenue	-	-	-	-	(829)	(829)	-	(829)
Fair value adjustments	-	-	-	-	52	52	-	52
Net finance costs	-	-	-	-	6,521	6,521	661	7,182
Earnings (loss) before income taxes	16,932	269	9,473	2,246	(22,516)	6,404	311	6,715
Income tax expense (recovery)								
Current	-	-	-	-	2,977	2,977	-	2,977
Deferred	-	-	-	-	(1,124)	(1,124)	(85)	(1,209)
Total income tax expense (recovery)	-	-	-	-	1,853	1,853	(85)	1,768
Net earnings (loss)	16,932	269	9,473	2,246	(24,369)	4,551	396	4,947

21. SUBSEQUENT EVENTS

Acquisition

On April 11, 2018, the Company completed the acquisition of the Lynde Creek Retirement Community for a cash purchase price of $34.5 million, subject to normal closing adjustments. The acquired community, located in Whitby, Ontario, consists of the Lynde Creek Manor Retirement Residence, offering 93 independent and assisted living suites; the Lynde Creek Life Lease Village, with 113 townhomes; and 3.7 acres of adjacent land for expansion. This acquisition was funded by cash on hand, and will be accounted for as a business combination.

Issue of 2025 Convertible Debentures and Redemption of 2019 Convertible Debentures

As previously announced, in April 2018 the Company issued $126.5 million aggregate principal amount of 5.00% convertible unsecured subordinated debentures due April 30, 2025 (the “2025 Debentures”), with a conversion price of $12.25 per Common Share (the “Offering”). The initial offering for $110.0 million of the 2025 Debentures closed on April 17, 2018, and the exercise of the over-allotment option for $16.5 million debentures closed on April 25, 2018.

The net proceeds from the Offering of $121.8 million (after deducting the Underwriters’ fee, before expenses of the Offering), together with cash on hand, was used by the Company to finance the redemption of its 2019 Debentures. The redemption price of the 2019 Debentures was equal to the sum of the outstanding aggregate principal amount of $126,500,000 and all accrued and unpaid interest thereon for a total of $127,123,645, or $1,004.93 for each $1,000 principal amount of 2019 Debentures. The notice of the redemption of all of the issued and outstanding 2019 Debentures was issued by the Company on March 26, 2018.

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