EXTENDICARE®
... helping people live better

2017 ANNUAL REPORT

# ENRICHING LIVES
# EMBRACING CHANGE

50 SINCE 1968
YEARS OF HELPING
PEOPLE LIVE BETTER

# Extendicare is reinve
# forms of senior care –
# perspective on delive
# care at the right time

## 2017 Achievements

Advanced to next stage of provincial review process on redevelopment plans for six Extendicare long-term care centres in Ontario

Built a 24-bed addition to Extendicare Eaux Claires, a long-term care centre in Edmonton that welcomed its first resident in February 2018

Opened Esprit's Douglas Crossing Retirement Community (103 suites) in Uxbridge, Ontario and began construction on a 47-suite expansion due to open late 2018

Commenced construction of two Esprit private-pay retirement communities in Bolton (112 suites) and Barrie (124 suites), Ontario

Successfully renewed ParaMed's status of *Exemplary Standing*, Accreditation Canada's highest award

Began management of seven new senior care centres under Extendicare Assist

Grew SGP Purchasing Partner Network's third-party clients served by 10%

# nting traditional –providing a new ring the right in the right place.


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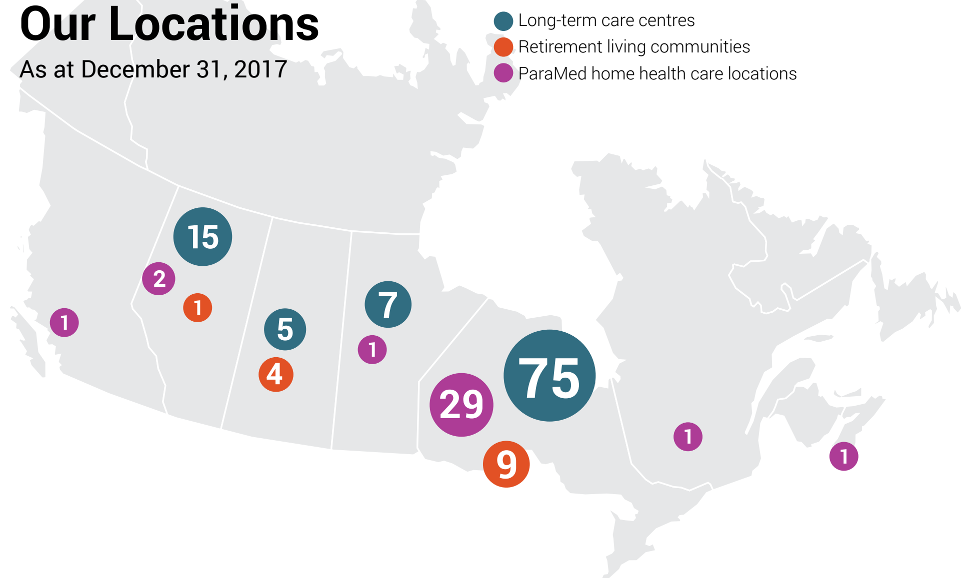
# AT A GLANCE

## 50 Years of Helping People Live Better

Extendicare's dedicated and experienced team has been helping people live better through a commitment to quality care and services that includes long-term care, retirement living, home health care, and management, consulting and group purchasing services.

## Our Locations

As at December 31, 2017




**58**
Extendicare – owned long-term care centres

**44**
Extendicare Assist – managed long-term care centres

**11.3M**
ParaMed Home Health Care hours delivered through 35 branches

**8**
Esprit Lifestyle Communities

**6**
Extendicare Assist – managed retirement living centres

**45.2K**
SGP Purchasing Partner Network third-party residents served

# Corporate Profile

Extendicare is a leading provider of care and services for seniors throughout Canada. Through our network of 116 operated senior care and living centres, as well as our home health care operations, we are committed to delivering care and services throughout the health care continuum to meet the needs of a growing seniors' population in Canada. Our qualified and highly trained workforce of 23,700 individuals is dedicated to helping people live better through a commitment to quality service and a passion for what we do.

Extendicare's common shares trade on the TSX under the symbol "EXE", and pay monthly cash dividends at the discretion of its board of directors. More information is available at www.extendicare.com.

# Financial Highlights

(millions of dollars unless otherwise noted)

**Revenue from Continuing Operations**

**NOI from Continuing Operations[1]**

**Adjusted EBITDA from Continuing Operations[1]**

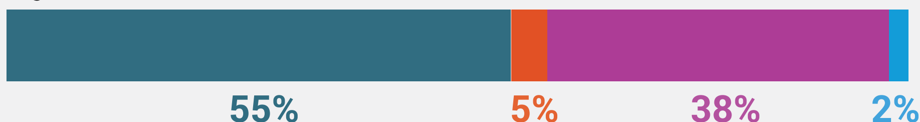
**AFFO from Canadian Continuing Operations[1]**

# Our Segments

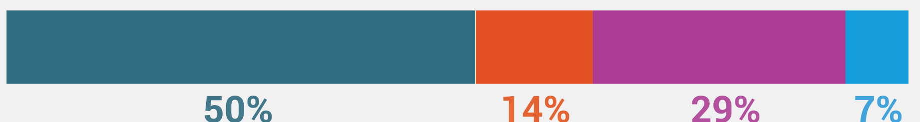
Pro forma 2017 revenue and NOI from Canadian operations for estimated stabilized impact of completed/committed transactions.

Long-term care · Retirement living · Home health care · Management, consulting and group purchasing

**Segmented Revenue**




**Segmented NOI**




(1) Refer to non-GAAP measures on page 18.

**Forward-looking Statements**

Information provided by Extendicare from time to time, including in this Annual Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to Extendicare and its subsidiaries, including, without limitation, statements regarding its business operations, business strategy and financial condition. Please refer to page 18 for a caution to the reader on the reliance of such statements.

# CONTINUUM OF CARE

**We offer a range of senior care services across the spectrum to ensure that Canadian seniors receive the care they need at any stage in their health care journey.**

**94%**
would recommend us

We strive to provide a positive, healthy and safe environment for those in our care. Extendicare's person-centred quality management program is focused on delivering consistent and effective care. Our program is guided by a quality framework that is based on customer needs and service quality.

Each year we conduct surveys as a means to assess our performance and identify opportunities for improvement. We have implemented a continuous review process that categorizes the feedback and turns them into actionable insights. These results help us understand what matters most to our clients and how best to serve them.

We are proud that our clients and their families have the confidence in the quality of our care and services, such that they would recommend our services to others.

## At Extendicare, we strongly believe that the best starting point in meeting the needs of our residents, is by asking them what's most important to them.

Rosemary Lindau and April Coulter, two Extendicare consultants, started "My Wishes" with the goal of incorporating what residents of our long-term care homes felt was most important to them in their end of life journey. Using cards, they were able to encourage discussion about end of life in a non-threatening way. Since its launch, the program has been introduced in nine homes to over 250 residents. This innovative program has received positive feedback across the health care sector. One achievement the team is proud of is the implementation of "My Wishes" into Extendicare's national policy on Advance Care Planning.

> "I have learned how powerful the voice of the resident is, and how impactful acting on their wishes can be. By simply listening... we can drive change in long-term care and beyond."

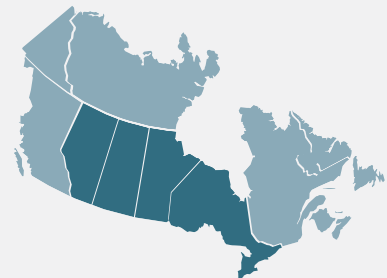
April Coulter, Extendicare Long-term Care Consultant

# LONG-TERM CARE

EXTENDICARE®
... helping people live better

8,112
Resident capacity

98%
Average occupancy



**Extendicare's long-term care services are designed for those who require a higher level of specialized nursing and personal care services.**

Extendicare is proud to be playing a leadership role in the renewal of older long-term care homes across Ontario, with a view to providing a non-institutional environment offering greater privacy and dignity for our residents. Enhancing the mix of preferred accommodation will improve our revenue stream and operating margins.

**84%**
Average occupancy of Ontario preferred accommodation

**11.5K**
Dedicated employees

**1.4%**
Year-over-year growth in revenue

"We would like to thank everyone for the exceptional care and attention paid to my mother since her admission to Extendicare Kirkland... you are an exceptional home and we feel very comfortable leaving our beloved mother in your care."

Long-term care centre family member,
Extendicare Kirkland Lake

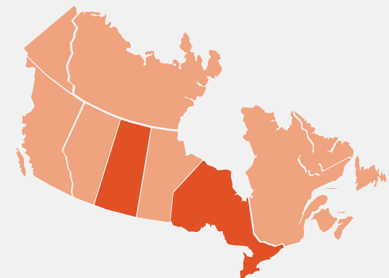
# RETIREMENT LIVING

**676**

Suites

**102**

Year-over-year increase in suites



## Our Esprit Lifestyle Communities allow residents to enjoy life to its fullest with the comfort of available care focused on enhancing and enriching lives.

We continue to expand the number of private-pay retirement communities through accretive acquisitions and developments under our Esprit Lifestyle Communities brand. This facilitates the diversification of our revenue stream and delivers higher operating margins.

**96%**

Occupancy of stabilized communities as at year end

**70%**

Average occupancy for 2017 (includes communities in lease up)

**23.9%**

Year-over-year increase in same-store NOI

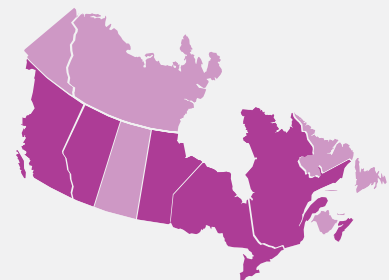
> "Seeing the horses helps my mother remember growing up, the cold winters, riding her horse to school after two to three hours of doing chores at home."

Retirement community family member on the horse therapy at Riverbend Crossing

# HOME HEALTH CARE

11.3M
Annual hours of service

31K
Daily hours of service



**ParaMed helps its clients enjoy greater independence at home by providing the highest quality of care as demonstrated by its *Exemplary Standing* ranking by Accreditation Canada.**

We continue to experience year-over-year increases in our home health care business volumes and clients served. ParaMed is positioned to meet the growing demand for quality cost-effective care in the community.

**11.7K**
Dedicated employees

**4.1%**
Year-over-year increase in daily hours of service

**9%**
Year-over-year growth in NOI

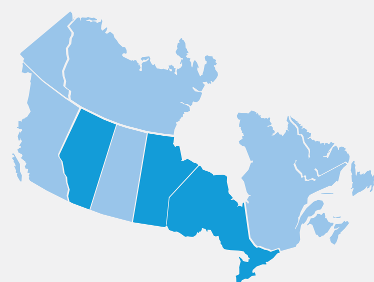
"I have been having a tough time with meals lately due to medication and not being able to eat. Skye, my home support worker, made meals I can and want to eat…she has gone above and beyond for me."

ParaMed client, Calgary AB

# MANAGEMENT AND CONSULTING SERVICES

**6,216**
Beds under management

**1.5%**
Year-over-year growth in combined (Extendicare Assist and SGP) revenue



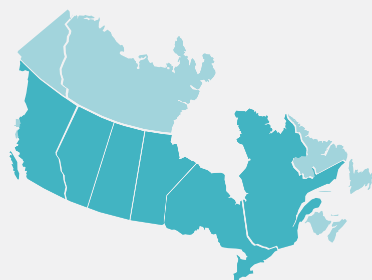
## Extendicare Assist offers management and consulting services to other health care operators in the areas of clinical care, dietary services, information technology, financial and administrative services, operational reviews and more.

We continue to seek out and develop new partnerships nationwide, including the provision of consulting services for development and redevelopment projects in the long-term care sector. We strive to improve the performance of our partners by applying our breadth of experience in the Canadian senior care sector.

# GROUP PURCHASING SERVICES

**45.2K**
Third-party residents served

**4.9%**
Year-over-year growth in combined (Extendicare Assist and SGP) NOI



## SGP Purchasing Partner Network provides its partners with quality national products and services; everything from food, clinical supplies, furniture and equipment to maintenance contracts.

We continue to build on our strong foundation by expanding our member base to include larger providers in additional markets. By continuously evaluating our product offerings and considering new innovations and trials, we gain efficiencies and enrich the lives of the residents we serve.

# LETTER TO SHAREHOLDERS

Mission Statement

**Extendicare is about helping people live better.**

**We help our residents and clients live better by promoting quality of life.**

**We create remarkable moments through highly engaged and motivated team members.**

**Stakeholders know this because we continuously measure, improve and publicly share our performance.**

Fellow Shareholders,

Fifty years ago, Extendicare was founded to become a long-term care (LTC) service provider that would relieve overburdened hospitals. Core to this vision was a commitment to establishing the highest standards of care that would enhance the lives of residents. This legacy of “helping people live better” lives on today.

In its first year of operation, the Company broke ground on four LTC centres in Ontario. Today, we own or operate over 100 LTC centres across the country serving over 13,500 residents. We have grown not only in size but in services across the continuum of care – where senior care centres that were once hospital-like, focused mainly on medical care, are now warm, home-like environments where a patient is cared for emotionally, spiritually and socially. We offer a variety of social and recreational activities such as horse therapy and memory care, and we have changed the ways of delivering care. We launched ParaMed in 1975 to serve seniors living in their homes, as “aging in place” has become more desirable. Extendicare is now the largest private-sector provider of both LTC and home health care in Canada.

Providing long-term care that positively impacts the lives of our residents remains a key focus. Thus, the redevelopment of our 21 Ontario Class C LTC beds is a priority, and we have an investment plan of approximately $400 million over the next five years to achieve this. To date, we have submitted applications to the Ministry of Health and Long-Term Care (MOHLTC) to redevelop 16 of our centres, including an additional 400 to 500 new LTC beds in response to the MOHLTC’s recent call for new licence applications. We have received word from the MOHLTC that our first redevelopment project is in the final stage of approval and we are optimistic about breaking ground in 2018. This 256-bed LTC project is in Stittsville, Ontario, a growing suburb of Ottawa, and will be part of a beautiful campus of care. We believe working with the provincial government to advance these projects

is an important initiative to improve the quality and privacy of accommodations for seniors and to secure this reliable revenue stream into the future.

To expand our footprint in the senior care sector and diversify our revenue with more private-pay businesses, we own and operate eight retirement communities under the Esprit Lifestyle Communities brand. Since launch, we have acquired six communities and completed development of two in markets with strong demand. Three of the communities that were acquired in 2015 achieved stabilized occupancy and, at the end of 2017, had a combined occupancy of 96%. Our newest centre, Douglas Crossing Retirement Community in Uxbridge, Ontario, welcomed its first resident on October 30, 2017, and after only four months of service achieved occupancy of 71%. As a result, we have proceeded with the construction of a 47-suite addition, anticipated to be completed in late 2018. Two additional retirement communities are under construction in Ontario, with our Bolton community slated to open in the fall of 2018, and our Barrie community to open in the summer of 2019. In February 2018, we announced an agreement to acquire Lynde Creek Retirement Community in Whitby, Ontario, for $34.5 million, with closing anticipated in April 2018. This growing segment of our business will then consist of 11 retirement communities that are expected to contribute stabilized NOI of approximately $21 million.

We believe that home care has an important role to play in the future of senior care in Canada. Remaining in their own home is often the preferred care option for seniors. It is also advocated by the government as a low-cost solution to meet the growing demographic demand. ParaMed, our home health care business, is a key partner with provincial governments in delivering high-quality home care and currently employs over 11,700 individuals servicing roughly 75,000 clients annually.

As well, our Extendicare Assist management and consulting services, and SGP Purchasing Partner Network continue to experience increased demand for our day to day management, application support and development services. By associating with these Extendicare business units, our clients leverage the expertise and economies of a larger organization.

## Stable Growth in 2017

Our results for 2017 reflect continued execution towards our stated strategy while increasing private-pay revenue from retirement living. Extendicare's revenue from continuing operations for 2017 grew to $1.10 billion, up 3.4% over 2016, driven by growth in our home health care business volumes, funding enhancements and higher preferred accommodation in our LTC operations, and continued growth of our retirement living operations. These factors contributed to the growth in NOI, from continuing operations of 4.4% to $135.8 million for the year.

Revenue and NOI from our Canadian operations each grew by 3.3%, reflecting an NOI margin of 12%, while AFFO from our Canadian operations of $58.4 million, or $0.657 per share, was relatively flat compared to 2016.

Our dividends paid in 2017 aggregated $0.48 per share, representing a payout ratio on total AFFO of 73%.

## Final Remarks

We expect radical change in the Canadian senior care landscape over the coming years. The aging demographic, as the number of people over 65 outpace those under 15 years of age, will dramatically impact the amount and nature of services demanded by Canadians. And governments, constrained in their capacity to meet this demand, will increasingly be looking to private-sector partners for solutions to meet these challenges.

Extendicare has grown to be a trusted senior care provider by being patient-centred and highly committed to quality care. We believe we are well positioned to adapt to changes and capture opportunities that will arise to meet the growth in demand for our services.

We owe our success to our team members on the frontlines – those who serve our clients as if they were their extended families. The health care landscape will continue to change; however, there is one thing that will not change – our team's commitment to helping people live better. We thank you for all of your support as we continue on our journey to being the best senior care and services company in Canada.

Sincerely,

Timothy L. Lukenda
President and Chief Executive Officer

# Corporate Information

## Extendicare Inc. Board of Directors

**Alan D. Torrie** HR, GN
Chairman of the Board

**Timothy L. Lukenda**
President and Chief Executive Officer

**Margery O. Cunningham** A
Corporate Director and Consultant

**Michael R. Guerriere** QR
Chief Medical Officer, Vice President and Chief Strategy Officer of TELUS Health

**Sandra L. Hanington** A, GN, QR
President and Chief Executive Officer of the Royal Canadian Mint

**Alan R. Hibben** A, AQ, GN
Corporate Director and Advisor

**Benjamin J. Hutzel** HR
Corporate Director

**Donna E. Kingelin** AQ, QR
Corporate Director and Consultant

**Al Mawani** A, AQ
Principal of Exponent Capital Partners Inc.

**Gail Paech** HR, QR
President and Chief Executive Officer of Associated Medical Services Inc.

Honorary Directors

**George A. Fierheller**
**Dr. Seth. B. Goldsmith**
**Alvin G. Libin**
**J. Thomas MacQuarrie, QC**

Committees

| | |
|---|---|
| A | Audit |
| AQ | Acquisitions |
| GN | Governance and Nominating |
| HR | Human Resources |
| QR | Quality and Risk |

## Officers and Executives

### Extendicare Inc.

**Timothy L. Lukenda**
President and Chief Executive Officer

**Elaine E. Everson**
Vice President and Chief Financial Officer

**Jillian E. Fountain**
Corporate Secretary

**Brandon L. Parent**
Vice President, General Counsel

### Extendicare (Canada) Inc.

**Timothy L. Lukenda**
Chairman and Chief Executive Officer

**Elaine E. Everson**
Vice President and Chief Financial Officer

**Jillian E. Fountain**
Corporate Secretary

**Christopher J. Dennis**
Vice President, Home Health Care Operations and President, ParaMed Inc.

**Michael A. Harris**
Vice President, LTC Operations

**Gary M. Loder**
Vice President, Extendicare Assist and SGP Purchasing Partner Network

**Mark A. Lugowski**
Vice President, Esprit Lifestyle Communities

**Christina L. McKey**
Vice President

**Tracey L. Mulcahy**
Vice President, Quality, Risk and Innovation

**Brandon L. Parent**
Vice President, General Counsel

**Karen A. Scanlan**
Vice President, People and Culture

# Management's Discussion and Analysis

**Year ended December 31, 2017**
**Dated: February 28, 2018**

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## Basis of Presentation

This Management's Discussion and Analysis (MD&A) provides information on Extendicare Inc. and its subsidiaries, and unless the context otherwise requires, references to "Extendicare", the "Company", "we", "us" and "our" or similar terms refer to Extendicare Inc., either alone or together with its subsidiaries. The Company's common shares (the "Common Shares") are listed on the Toronto Stock Exchange (TSX) under the symbol "EXE". The registered office of Extendicare is located at 3000 Steeles Avenue East, Suite 700, Markham, Ontario, Canada, L3R 9W2.

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

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

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

The discussion and analysis in this MD&A are based upon information available to management as of February 28, 2018. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other events may or may not occur, which could affect the Company in the future.

## Additional Information

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

## Forward-looking Statements

Information provided by Extendicare from time to time, including in this Annual Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to the Company, including, without limitation, statements regarding its business operations, business strategy, growth strategy, results of operations and financial condition; statements relating to indemnification provisions and deferred consideration in respect of the U.S. Sale Transaction; and the acquisition and development of retirement communities, including statements related to the expected annual revenue, net operating income (NOI) yield, and adjusted funds from operations to be derived from acquisitions and development projects. Forward-looking statements can be identified by the expressions "anticipate", "believe", "estimate", "expect", "intend", "objective", "plan", "project", "will" or other similar expressions or the negative thereof. These forward-looking statements reflect the Company's current expectations regarding future results, performance or achievements and are based upon information currently available to the Company and on assumptions that the Company believes are reasonable.

Although forward-looking statements are based upon estimates and assumptions that the Company believes are reasonable based upon information currently available, these statements are not representations or guarantees of future results, performance or achievements of the Company and are inherently subject to significant business, economic and competitive uncertainties and contingencies. In addition to the assumptions and other factors referred to specifically in connection with these forward-looking statements, the risks, uncertainties and other factors that could cause the actual results, performance or achievements of Extendicare to differ materially from those expressed or implied by the forward-looking statements, include, without limitation, the following: changes in the overall health of the economy and government; the ability of the Company to attract and retain qualified personnel; changes in the health care industry in general and the long-term care industry in particular because of political and economic influences; changes in applicable accounting policies; changes in regulations governing the health care and long-term care industries and the compliance by Extendicare with such regulations; changes in government funding levels for health care services; changes in tax laws; resident care and class action litigation, including the Company's exposure to punitive damage claims, increased insurance costs and other claims; the ability of Extendicare to maintain and increase resident occupancy levels and home health care volumes; changes in competition; changes in demographics and local environment economies; changes in foreign exchange and interest rates; changes in the financial markets, which may affect the ability of Extendicare to refinance debt; and the availability and terms of capital to Extendicare to fund capital expenditures and acquisitions; changes in the anticipated outcome and benefits of dispositions, acquisitions and development projects, including risks relating to completion; and those other risks, uncertainties and other factors identified in the Company's other public filings with the Canadian securities regulators available on SEDAR's website at www.sedar.com under Extendicare's issuer profile.

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

## Non-GAAP Measures

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

References to “net operating income”, or “NOI”, in this document are to revenue less operating expenses, and this value represents the underlying performance of our operating business segments. References to “net operating income margin” are to net operating income as a percentage of revenue.

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

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

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

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

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

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

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

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

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

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

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

## Business Strategy

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

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

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

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

## Significant 2017 Events and Developments

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

### Growth of Retirement Operations

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

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

#### Retirement Acquisitions

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

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

### Projects in Development

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

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

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

### Retirement Community Financings

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

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

## Business Overview

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

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

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

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

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

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

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

## Operating Segments

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

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

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

### Long-term Care (including government-funded supportive living)

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

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

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

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

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

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

### Retirement Living

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

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

## Home Health Care

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

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

## Other Canadian Operations

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

### *Management and Consulting Services*

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

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

### *Group Purchasing Services*

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

## U.S. Remaining Operations — Captive Insurance Company

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

As at December 31, 2017, the accrual for U.S. self-insured general and professional liabilities was $61.1 million (US$48.6 million) compared to US$70.6 million at the beginning of the year, and the investments held for U.S. self-insured liabilities totalled $86.3 million (US$68.6 million) compared to US$101.4 million at the beginning of the year, with the decline in each reflecting the "run off" of these operations. During 2017, following the completion of independent actuarial reviews, the Company released US$4.4 million of reserves for self-insured liabilities, bringing the total released since the sale of the U.S. operations in 2015 to US$19.7 million. Following the release of these reserves, the Captive has transferred US$21.0 million of its funds previously held for investment to the Company for general corporate use, of which US$16.0 million was transferred in 2017 and US$5.0 million was transferred in 2016. The loss provisions for our U.S. general and professional liability risks are based upon management's best available information, including independent actuarial estimates. The Captive is currently appropriately capitalized, but there can be no assurance that it will remain as such in the future should general and professional liability claims incurred prior to the closing of the U.S. Sale Transaction, including claims incurred but yet to be reported, increase significantly. For further information on our self-insured liabilities, refer to the discussion under the heading "Accrual for U.S. Self-insured Liabilities" found within the "Liquidity and Capital Resources" section of this MD&A.

## Key Performance Indicators

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

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

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

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

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

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

### Long-term Care

The average occupancy at our LTC centres was 97.7% this quarter compared to 97.9% in the 2016 fourth quarter, and for the year was 97.7% compared to 98.0% in 2016. In terms of the quarterly trends throughout the year, slightly lower occupancy levels are to be expected during the winter months as a result of outbreaks, which can lead to temporary freezes on admissions.

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

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

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

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

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

## Retirement Living

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

### As at Occupancy

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

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

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

### Average Occupancy

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

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

## Home Health Care

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

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

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

## 2017 Selected Annual Information

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

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

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

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

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

## 2017 Selected Quarterly Information

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

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

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

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

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

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

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

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

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

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

## 2017 Fourth Quarter Financial Review

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

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

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

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

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

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

## Consolidated Revenue

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

## Consolidated Operating Expenses

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

## Consolidated Net Operating Income

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

## Administrative and Lease Costs

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

## Consolidated Adjusted EBITDA

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

## Net Finance Costs (Income)

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

## Income Taxes

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

## Discontinued Operations

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

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

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

## Summary of Results of Operations by Segment

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

### Long-term Care Operations

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

### Retirement Living Operations

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

### Home Health Care Operations

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

### Other Canadian Operations

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

### U.S. Operations

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

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

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

## 2017 Financial Review

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

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

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

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

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

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

## Consolidated Revenue

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

## Consolidated Operating Expenses

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

## Consolidated Net Operating Income

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

## Administrative and Lease Costs

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

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

## Consolidated Adjusted EBITDA

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

## Depreciation and Amortization

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

## Other Expense

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

## Net Finance Costs (Income)

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

## Income Taxes

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

## Discontinued Operations

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

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

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

## Summary of Results of Operations by Segment

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

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

### Long-term Care Operations

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

### Retirement Living Operations

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

### Home Health Care Operations

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

### Other Canadian Operations

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

### U.S. Operations

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

## Adjusted Funds from Operations

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

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

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

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

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

## AFFO 2017 Fourth Quarter Financial Review

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

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

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

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

## AFFO 2017 Financial Review

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

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

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

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

## Reconciliation of Net Cash from Operating Activities to AFFO

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

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

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

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

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

# Other Significant Developments

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

## Expansion of Alberta Long-term Care Centre

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

## 2015 U.S. Sale Transaction — Deferred Consideration

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

## 2016 Sale of U.S. IT Hosting Business

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

### Other Financing Activity

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

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

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

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

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

### Tax Reassessment

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

## Update of Regulatory and Funding Changes Affecting Results

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

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

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

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

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

## Ontario Redevelopment Program

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

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

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

## Ontario Long-term Care Funding

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

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

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

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

## Alberta Long-term Care Funding

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

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

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

## Ontario Home Health Care Funding

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

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

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

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

## Liquidity and Capital Resources

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

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

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

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

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

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

The following table summarizes the components of our property, equipment and other intangible asset expenditures between our continuing and discontinued operations for each of 2017 and 2016. Growth capex, excluding acquisitions, relates to the construction of new beds, building improvements or other capital costs, all of which are aimed at earnings growth. The increase in growth capex relates primarily to the retirement communities currently under development in Ontario. Maintenance capex relates to our actual capital expenditures incurred to sustain and upgrade existing property and equipment. Management monitors the capital expenditure

requirements of its properties throughout the year, and prioritizes its capital projects taking into account the urgency and necessity of the expenditure. In 2018, we are projecting to spend in the range of $9 million to $10 million in maintenance capex, and in the range of $50 million to $55 million in growth capex related primarily to the retirement development projects.

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

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

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

## Capital Structure

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

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

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

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

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

### Distributions

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

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

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

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

### Normal Course Issuer Bid

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

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

## Future Liquidity and Capital Resources

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

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

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

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

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

# Commitments and Contingencies

## Long-term Debt

### Continuity of Long-term Debt

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

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

### Long-term Debt Maturities and Weighted Average Interest Rates

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

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

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

(1) Net interest coverage is defined as Adjusted EBITDA divided by net interest (interest expense before reduction of capitalized interest, net of interest revenue).

(2) Interest coverage is defined as Adjusted EBITDA divided by interest expense before reduction of capitalized interest.

(3) Debt includes convertible debentures at face value of $126.5 million, and excludes finance costs.

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

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

## Other Contractual Obligations and Contingencies

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

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

### Defined Benefit Pension Plan Obligations

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

### Accrual for U.S. Self-insured Liabilities

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

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

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

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

Most of the risks that Extendicare self-insures are long-term in nature, and accordingly, claim payments for any particular policy year occur over a long period of time. However, management estimates and allocates a current portion of the accrual for self-insured liabilities on the statement of financial position. As at December 31, 2017, management estimated that approximately $22.7 million of the accrual for self-insured general and professional liabilities will be paid within the next year. The timing of payments is not directly within management's control; therefore, estimates could change in the future.

Within our Bermuda-based captive insurance company, we hold investments sufficient to support the accrual for self-insured liabilities and to meet required statutory solvency and liquidity ratios. These invested funds are reported in other assets and totalled $86.3 million (US$68.6 million) as at December 31, 2017, compared to $136.1 million (US$101.4 million) as at December 31, 2016. During the 2017, the Captive transferred US$16.0 million of its funds previously held for investment to the Company for general corporate use. Management believes there are sufficient invested funds held to meet estimated current claims payment obligations.

#### Legal Proceedings, Claims and Regulatory Actions

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

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

## Related Party Transactions

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

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

## Risks and Uncertainties

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

### General Business Risks

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

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

## Risks Related to Growth Activities

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

The provinces restrict the number of licensed LTC beds and any new licenses are awarded through a request for proposal process. If regulatory approvals are required in order to expand operations of the Company, the failure of the Company or inability to obtain the necessary approvals, changes in standards applicable to such approvals and possible delays and expenses associated with obtaining such approvals could adversely affect the ability of the Company to expand and, accordingly, to increase its revenue and earnings.

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

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

## Risks Related to Occupancy and Business Volumes

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

## Risks Related to Government Funding and Regulatory Changes

### General

Extendicare's earnings are highly reliant on government funding and reimbursement programs, and the effective management of staffing and other costs of operations, which are strictly monitored by government regulatory authorities. Given that we operate in a labour-intensive industry, where labour costs account for a significant portion of our operating costs (approximately 87% in 2017), government funding constraints, or funding enhancements that are not commensurate with increased costs, could have a significant adverse effect on the Company's results from operations and cash flows. Management is unable to predict whether governments will adopt changes in their funding and reimbursement programs, and if adopted and implemented, what effect such changes will have on the Company.

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

All long-term care providers are subject to surveys, inspections, audits and investigations by government authorities to ensure compliance with applicable laws and licensure requirements of the various government funding programs. Long-term care centres must comply with applicable regulations that, depending on the jurisdiction in which they operate, may relate to such matters as staffing levels, resident care related operating standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental and other standards. Retirement communities are also subject to extensive government regulation and oversight, licensure requirements and the potential for regulatory change. The government review process is intended to determine compliance with survey and certification requirements, and other applicable laws. Remedies for survey deficiencies can be levied based upon the scope and severity of the cited

deficiencies. Remedies range from the assessment of fines to the withdrawal of payments under the government funding programs. Should a deficiency not be addressed through a plan of correction, a centre can be decertified from the funding program. Extendicare makes every effort to avoid and mitigate notices of deficiencies through quality assurance strategies. As well, all efforts are undertaken to correct all legitimate problem areas that have been identified through regulatory inspections.

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

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

### Ontario LTC Redevelopment Program

In Ontario, licenses for LTC centres are issued for a fixed term of not more than 30 years, after which a new license may or may not be issued. LTC operators are to be notified of license renewals at least three years prior to the maturity date. Under the LTCHA, license terms for Class B and C LTC centres are set to expire in 2025 unless the centres are redeveloped to the government's new design standards. In Ontario, Extendicare has 21 Class C LTC centres with 3,287 beds that it plans to redevelop under the government's enhanced redevelopment program (see "Ontario Redevelopment Program" under the heading "Update of Regulatory and Funding Changes Affecting Results"). The extent to which such redevelopment plans are not implemented or proceed on significantly different timing or terms, including levels of expected government subsidy funding, could have a material adverse effect on the business, results of operations and financial condition of the Company.

### Ontario Home Health Care Business

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

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

## Risks of Rising Personnel Costs and Related to Labour Relations

### Personnel Costs

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

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

### Labour Relations

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

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

## Risks Related to Liability and Insurance

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

Extendicare maintains business and property insurance policies in amounts and with such coverage and deductibles as deemed appropriate, based on the nature and risks of the business, historical experience and industry standards. There can be no assurance, however, that claims in excess of the insurance coverage, or in excess of the Company's reserves, or claims not covered by the insurance coverage will not arise or that the liability coverage will continue to be available on acceptable terms. Furthermore, there are certain types of risks, generally of a catastrophic nature, such as war, non-certified acts of terrorism, or environmental contamination, which are either uninsurable or are not insurable on an economically viable basis. A successful claim against the Company not covered by, or in excess of, such insurance, or in excess of the Company's reserves for self-insured retention levels, could have a material adverse effect on the business, results of operations and financial condition of the Company. Claims against the Company, regardless of their merit or eventual outcome, may also have a material adverse effect on the ability of the Company to attract residents, expand the business of the Company or maintain favourable standings with regulatory authorities.

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

## Risks Related to Tax Rules and Regulations

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

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

## Risks Related to Financing

### Debt Financing

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

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

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

The Company cannot predict whether future financing will be available, what the terms of such future financing will be (including, whether it will result in a higher cost of borrowing) or whether its existing debt agreements will allow for the timely arrangement and implementation of such future financing. If the Company were unable to obtain additional financing or refinancing when needed or on satisfactory terms, it could have a material adverse effect on the business, results of operations and financial condition of the Company.

### Debt Covenants

The Company is in compliance with all of its financial covenants as at December 31, 2017. However, there can be no assurance that future covenant requirements will be met. The Company's bank lines and other debt may be affected by its ability to remain in compliance. If the Company does not remain in compliance with its financial covenants, its ability to amend the covenants or refinance its debt may be affected.

### Interest Rates

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

## Risks Related to Property Ownership

### Real Property Ownership

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

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

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

### Capital Intensive Industry

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

### Environmental Liabilities

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

Management has determined that future costs could be incurred for possible asbestos remediation of the Company's pre-1980 constructed centres. Although asbestos is currently not a health hazard in any of these centres, appropriate remediation procedures may be required to remove potential asbestos-containing materials, consisting primarily of floor and ceiling tiles, in connection with any major renovation or demolition. Based upon current assumptions, the estimated fair value of the decommissioning provision related to the asbestos remediation was approximately $11 million undiscounted, or $9.2 million discounted, as at December 31, 2017, refer to *note 11* of the audited consolidated financial statements.

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

## Risks Related to Dependence on Key Personnel

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

## Risks Related to Privacy of Client Information and Cyber Security

As a custodian of a large amount of personal information, including health information, relating to its clients and employees, Extendicare is exposed to the potential loss, misuse or theft of any such information. If the Company was found to be in violation of the federal and provincial laws protecting the confidentiality of patient health information, it could be subject to sanctions and civil or criminal penalties, which could increase its liabilities, harm its reputation and have a material adverse effect on the business, results of operations and financial condition of the Company. In addition, cyber attacks against large organization are increasing in sophistication and are often focused on financial fraud, compromising sensitive data for inappropriate use or disrupting business operations. Extendicare mitigates this risk by deploying appropriate information technology systems, including controls around logical access, physical access and data management, and training its employees relating to safeguarding of sensitive information.

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

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

## Accounting Policies and Estimates

### Critical Accounting Policies and Estimates

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

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

#### Valuation of Purchase Price Components for Acquisitions

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

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

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

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

#### Valuation of Deferred Consideration

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

#### Valuation of Cash Generating Units and Impairment

Non-financial assets consist of property and equipment, intangible assets with finite lives, intangible assets with indefinite lives and goodwill. Property, plant and equipment represents approximately 51% of our total assets as at December 31, 2017, and goodwill and other intangibles represent approximately 10%. A CGU is defined to be the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets. The Company has identified each individual centre as a CGU.

Goodwill and indefinite-life intangibles are tested annually, except in the year of acquisition, and other assets are assessed for impairment when indicators of impairment exist. If any such indication exists, then the asset's recoverable amount is reassessed. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated annually at the same time or more frequently if warranted. An impairment loss is recognized in net earnings if the carrying amount of an asset or its related CGU, or group of assets on the same basis as evaluated by management, exceeds its estimated recoverable amount. The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

The determination of recoverable amounts can be significantly impacted by estimates related to current market valuations, current and future economic conditions in the geographical markets of each CGU, and management's strategic plans within each of its markets. Estimates and assumptions used in the determination of any impairment loss are based upon information that is known at the time, along with future outlook. When impairment tests are performed, the estimated useful lives of the assets are reassessed, with any change accounted for prospectively. Actual results can differ from these estimates, and can have either a positive or negative impact on the estimate, and impact whether an impairment situation exists.

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

### Valuation of Indemnification Provisions

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

### Self-insured Liabilities of Discontinued Operations

The obligation to settle any U.S. self-insured general and professional liability claims relating to the period prior to the closing of the U.S. Sale Transaction in July 2015, including claims incurred but yet to be reported, remains with Extendicare, which it intends to fund through the Captive. The accrual for U.S. self-insured liabilities of our former U.S. operations is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. The Company estimates the value of losses that may occur within its self-insured retention levels, based upon individual assessment of the settlement, using historical information and industry data, supported by actuarial projections, advice from legal counsel, consultants and external risk management. Actual results can differ materially from the estimates made due to a number of factors including the assumptions used by management and other market forces.

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

At December 31, 2017, the accrual for self-insured general and professional liabilities was $61.1 million or US$48.6 million (2016 — $94.8 million or US$70.6 million). Investments held by the Captive to support these accruals totalled $86.3 million (US$68.6 million) as at December 31, 2017. Changes in the level of retained risk and other significant assumptions that underlie management's estimates could have a material effect on the future carrying value of the self-insured liabilities. For example, a 1% variance in the accrual for U.S. self-insured liabilities at December 31, 2017, would have impacted our net earnings from discontinued operations by approximately $0.6 million (US$0.5 million). For further information refer to the discussion under the heading "Liquidity and Capital Resources — Accrual for U.S. Self-Insured Liabilities".

### Tax Uncertainties

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

### Deferred Tax Assets and Liabilities

The Company uses the asset and liability method of accounting for deferred income taxes, which takes into account the differences between financial statement treatment and tax treatment of certain transactions, assets and liabilities. Deferred tax assets and liabilities are recognized to reflect the expected future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to be recovered or settled. In assessing whether the deferred tax assets are realizable, management considers whether it is probable (which the Company has defined as "more likely than not") that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. As at December 31, 2017, the Company had recognized deferred tax assets totalling $13.9 million (2016 — $15.3 million). Management believes that it is more likely than not that the Company will realize the benefits of these deductible differences. In addition, as at December 31, 2017, there were capital losses available for Canadian income tax purposes of $16.5 million (2016 — $13.8 million) that have not been tax benefited and are available indefinitely to apply against future capital gains.

## New Accounting Policies Adopted

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

### Classification and Measurement of Share-based Payment Transactions

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

### Recognition of Deferred Tax Assets for Unrealized Losses

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

## Future Changes in Accounting Policies

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

### Revenue Recognition

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

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

### Financial Instruments

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

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

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

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

### Leases

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

## Disclosure Controls and Procedures

Management is responsible for establishing and maintaining a system of disclosure controls and procedures (DC&P) to provide reasonable assurance that all material information relating to the Company is gathered and reported to senior management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the DC&P was conducted as at December 31, 2017, by management under the supervision of the Company's CEO and CFO. Based on this evaluation, the CEO and CFO have concluded that our disclosure controls and procedures, as defined by National Instrument 52-109, *Certification of Disclosures in Issuers' Annual and Interim Filings*, were effective as at December 31, 2017.

## Internal Control over Financial Reporting

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

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

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

# Consolidated Financial Statements

**Year ended December 31, 2017**
**Dated: February 28, 2018**


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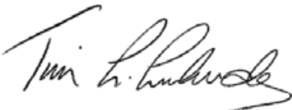
## Management's Responsibility for Consolidated Financial Statements

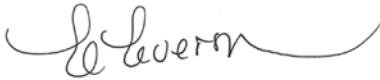
The accompanying consolidated financial statements of Extendicare Inc. ("Extendicare" or the "Company") and other financial information contained in this Annual Report are the responsibility of management. The consolidated financial statements have been prepared in conformity with International Financial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

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

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

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





TIMOTHY L. LUKENDA
President and Chief Executive Officer

ELAINE E. EVERSON
Vice President and Chief Financial Officer

February 28, 2018

# Independent Auditors' Report

## To the Shareholders of Extendicare Inc.

We have audited the accompanying consolidated financial statements of Extendicare Inc. ("Extendicare" or the "Company"), which comprise the consolidated statements of financial position as at December 31, 2017, and December 31, 2016, and the consolidated statements of earnings, comprehensive income (loss), changes in equity, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

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

### Auditors' Responsibility

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

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

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

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Extendicare Inc. as at December 31, 2017, and December 31, 2016, and its consolidated financial performance and its consolidated cash flows for the years then ended, in accordance with International Financial Reporting Standards.

Chartered Professional Accountants,
Licensed Public Accountants

Toronto, Canada
February 28, 2018

# Consolidated Statements of Financial Position

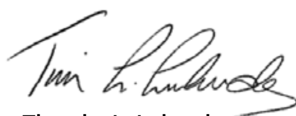
As at December 31

| *(in thousands of Canadian dollars)* | *notes* | **2017** | 2016 |
|---|---|---|---|
| **Assets** | | | |
| Current assets | | | |
| Cash and short-term investments | | **128,156** | 101,582 |
| Restricted cash | | **2,300** | 2,227 |
| Accounts receivable | *7* | **42,491** | 52,234 |
| Income taxes recoverable | | **7,194** | 3,058 |
| Other assets | *10* | **20,634** | 25,251 |
| Total current assets | | **200,775** | 184,352 |
| Non-current assets | | | |
| Property and equipment | *8* | **479,968** | 465,433 |
| Goodwill and other intangible assets | *9* | **95,901** | 89,770 |
| Other assets | *10* | **143,746** | 233,715 |
| Deferred tax assets | *23* | **13,891** | 15,347 |
| Total non-current assets | | **733,506** | 804,265 |
| **Total Assets** | | **934,281** | 988,617 |
| **Liabilities and Equity** | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | | **123,420** | 121,830 |
| Income taxes payable | | **3,500** | 430 |
| Long-term debt | *12* | **59,664** | 54,826 |
| Provisions | *11* | **29,937** | 31,419 |
| Total current liabilities | | **216,521** | 208,505 |
| Non-current liabilities | | | |
| Long-term debt | *12* | **476,404** | 448,742 |
| Provisions | *11* | **63,062** | 100,006 |
| Other long-term liabilities | *13* | **35,022** | 36,039 |
| Deferred tax liabilities | *23* | **14,316** | 20,566 |
| Total non-current liabilities | | **588,804** | 605,353 |
| **Total Liabilities** | | **805,325** | 813,858 |
| Share capital | *15* | **490,881** | 489,656 |
| Equity portion of convertible debentures | *12* | **5,573** | 5,573 |
| Contributed surplus | *14* | **2,437** | 941 |
| Accumulated deficit | | **(365,084)** | (322,025) |
| Accumulated other comprehensive income (loss) | | **(4,851)** | 614 |
| **Shareholders' Equity** | | **128,956** | 174,759 |
| **Total Liabilities and Equity** | | **934,281** | 988,617 |

*See accompanying notes to consolidated financial statements.*
Commitments and contingencies *(note 24)*.
Subsequent events *(notes 15 and 31)*.

Approved by the Board

**Alan D. Torrie**
Chairman



**Timothy L. Lukenda**
President and Chief Executive Officer

## Consolidated Statements of Earnings

Years ended December 31

| *(in thousands of Canadian dollars except for per share amounts)* | *notes* | **2017** | 2016 |
|---|---|---|---|
| **CONTINUING OPERATIONS** | | | |
| **Revenue** | | | |
| Long-term care | | **616,887** | 608,618 |
| Retirement living | | **20,673** | 15,474 |
| Home health care | | **435,718** | 414,406 |
| Management, consulting and other | | **24,053** | 22,260 |
| **Total revenue** | *17, 29* | **1,097,331** | 1,060,758 |
| Operating expenses | | **961,509** | 930,622 |
| Administrative costs | | **31,467** | 30,551 |
| Lease costs | | **6,758** | 6,650 |
| **Total expenses** | *18* | **999,734** | 967,823 |
| **Earnings before depreciation, amortization, and other expense** | | **97,597** | 92,935 |
| Depreciation and amortization | | **31,379** | 31,179 |
| Other expense | *19* | **–** | 4,013 |
| **Earnings before net finance costs and income taxes** | | **66,218** | 57,743 |
| Interest expense | | **28,082** | 27,039 |
| Accretion of decommissioning provisions | | **349** | 349 |
| Other accretion | | **2,463** | 2,152 |
| Loss (gain) on foreign exchange | *20* | **(864)** | 1,198 |
| Interest revenue | | **(3,902)** | (10,838) |
| Fair value adjustments | *20* | **(2,474)** | (985) |
| Net finance costs | | **23,654** | 18,915 |
| **Earnings before income taxes** | | **42,564** | 38,828 |
| **Income tax expense** | | | |
| Current | | **10,149** | 5,801 |
| Deferred | | **703** | 1,610 |
| Total income tax expense | *23* | **10,852** | 7,411 |
| **Earnings from continuing operations** | | **31,712** | 31,417 |
| | | | |
| **DISCONTINUED OPERATIONS** | | | |
| Loss on sale of U.S. operations, net of income taxes | *22* | **—** | (8,458) |
| Earnings (loss) from discontinued operations, net of income taxes | *22* | **(29,580)** | 12,493 |
| **Net earnings** | | **2,132** | 35,452 |
| | | | |
| **Basic and Diluted Earnings per Share** | | | |
| Earnings from continuing operations | *21* | **0.36** | 0.36 |
| Net earnings | *21* | **0.02** | 0.40 |

*See accompanying notes to consolidated financial statements.*

# Consolidated Statements of Comprehensive Income (Loss)

Years ended December 31

| *(in thousands of Canadian dollars)* | *notes* | **2017** | 2016 |
|---|---|---|---|
| **Net earnings** | | **2,132** | 35,452 |
| **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 | *23, 25* | **(311)** | 2,313 |
| Items that are or may be reclassified subsequently to profit or loss: | | | |
| Unrealized gain on available-for-sale securities, net of tax | | **4,955** | 5,574 |
| Reclassification of realized gains on available-for-sale securities to earnings, net of tax | | **(7,012)** | (2,532) |
| Foreign currency translation adjustment reclassified to gain on sale of U. S. operations, net of tax | | **—** | (1,431) |
| Other net change in foreign currency translation adjustment | | **(3,097)** | (1,532) |
| Total items that are or may be reclassified subsequently to profit or loss | *16, 23* | **(5,154)** | 79 |
| Other comprehensive income (loss), net of tax | | **(5,465)** | 2,392 |
| **Total comprehensive income (loss)** | | **(3,333)** | 37,844 |

*See accompanying notes to consolidated financial statements.*

# Consolidated Statements of Changes in Equity

Years ended December 31

| | 2017 | | 2016 | |
|---|---|---|---|---|
| *(in thousands of Canadian dollars)* | ***Number of Shares*** | **Amount** | *Number of Shares* | Amount |
| **Share Capital** *(note 15)* | | | | |
| Balance at January 1 | ***88,684,485*** | **489,656** | *87,953,291* | 483,385 |
| DRIP | ***535,025*** | **5,081** | *731,194* | 6,271 |
| Purchase of shares for cancellation | ***(696,220)*** | **(3,856)** | — | — |
| Balance at end of year | ***88,523,290*** | **490,881** | *88,684,485* | 489,656 |
| **Equity Portion of Convertible Debentures** | | | | |
| Balance at January 1 | | **5,573** | | 5,573 |
| Balance at end of year | | **5,573** | | 5,573 |
| **Contributed Surplus** | | | | |
| Balance at January 1 | | **941** | | — |
| Share-based compensation | | **1,496** | | 941 |
| Balance at end of year | | **2,437** | | 941 |
| **Accumulated Deficit** | | | | |
| Balance at January 1 | | **(322,025)** | | (315,051) |
| Net earnings | | **2,132** | | 35,452 |
| Dividends declared | | **(42,583)** | | (42,422) |
| Purchase of shares for cancellation in excess of book value | | **(2,599)** | | — |
| Other | | **(9)** | | (4) |
| Balance at end of year | | **(365,084)** | | (322,025) |
| **Accumulated Other Comprehensive Income** | | | | |
| Foreign currency translation differences for foreign operations | | | | |
| Balance at January 1 | | **3,775** | | 6,738 |
| Foreign currency translation adjustment reclassified to gain on sale of U.S. operations *(note 22)* | | **—** | | (1,431) |
| Change in the year | | **(3,097)** | | (1,532) |
| Balance at end of year | | **678** | | 3,775 |
| Net change in fair value of available-for-sale financial assets, net of tax | | | | |
| Balance at January 1 | | **6,391** | | 3,349 |
| Unrealized change in the year | | **4,955** | | 5,574 |
| Net change reclassified to profit or loss | | **(7,012)** | | (2,532) |
| Balance at end of year | | **4,334** | | 6,391 |
| Defined benefit plan actuarial losses, net of tax | | | | |
| Balance at January 1 | | **(9,552)** | | (11,865) |
| Change in the year | | **(311)** | | 2,313 |
| Balance at end of year | | **(9,863)** | | (9,552) |
| Accumulated other comprehensive income (loss) | | **(4,851)** | | 614 |
| **Shareholders' Equity** | | **128,956** | | 174,759 |

*See accompanying notes to consolidated financial statements.*

## Consolidated Statements of Cash Flows

Years ended December 31

| *(in thousands of Canadian dollars)* | **2017** | 2016 |
|---|---|---|
| **Operating Activities** | | |
| Net earnings | **2,132** | 35,452 |
| Adjustments for: | | |
| Depreciation and amortization | **31,379** | 32,364 |
| Share-based compensation | **1,496** | 941 |
| Deferred taxes | **(5,063)** | 963 |
| Current taxes | **8,919** | 14,319 |
| Net finance costs | **26,992** | 18,718 |
| Other expense (gains) | **36,576** | (9,998) |
| Loss (gain) on foreign exchange and fair value adjustments | **(3,338)** | 213 |
| Other | **240** | — |
| | **99,333** | 92,972 |
| Net change in operating assets and liabilities | | |
| Accounts receivable | **9,569** | (8,319) |
| Other assets | **4,283** | 14,566 |
| Accounts payable and accrued liabilities | **(6,144)** | (33,590) |
| | **107,041** | 65,629 |
| Payments for U.S. self-insured liabilities | **(24,160)** | (32,976) |
| Interest paid | **(29,560)** | (26,540) |
| Interest received | **3,932** | 10,835 |
| Income taxes paid | **(10,093)** | (16,637) |
| **Net cash from operating activities** | **47,160** | 311 |
| **Investing Activities** | | |
| Purchase of property, equipment and other intangible assets | **(41,137)** | (38,837) |
| Acquisitions *(note 6)* | **—** | (40,500) |
| Tax payments related to the U.S. Sale Transaction | **—** | (10,808) |
| Net proceeds from dispositions *(note 22)* | **—** | 9,534 |
| Decrease in investments held for self-insured liabilities | **41,142** | 37,956 |
| Decrease in other assets | **5,591** | 25,213 |
| **Net cash from investing activities** | **5,596** | (17,442) |
| **Financing Activities** | | |
| Issue of long-term debt, excluding line of credit | **43,654** | 68,855 |
| Repayment of long-term debt, excluding line of credit | **(22,029)** | (21,006) |
| Decrease (increase) in restricted cash | **(73)** | 4,783 |
| Purchase of securities for cancellation | **(6,455)** | — |
| Dividends paid | **(37,507)** | (36,122) |
| Other | **(1,202)** | (702) |
| **Net cash from financing activities** | **(23,612)** | 15,808 |
| Increase (decrease) in cash and short-term investments | **29,144** | (1,323) |
| Cash and short-term investments at beginning of year | **101,582** | 103,622 |
| Foreign exchange loss on cash held in foreign currency | **(2,570)** | (717) |
| **Cash and short-term investments at end of year** | **128,156** | 101,582 |

*See accompanying notes to consolidated financial statements.*

# Notes to Consolidated Financial Statements

Years ended December 31, 2017 and 2016

*(Tabular amounts in thousands of Canadian dollars, unless otherwise noted)*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## 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 substantially all of its U.S. business in 2015 and the repositioning of the Company as a pure-play Canadian services provider to the expanding senior care sector, management has successfully deployed the sale proceeds to expand and grow the Company's operations across the continuum of seniors' care.

In July 2015, Extendicare completed the sale of substantially all of its U.S. business and senior care operations (the "U.S. Sale Transaction"), the operations of which were conducted through its wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"). In December 2016, the Company disposed of its non-strategic U.S. information technology hosting and professional services (U.S. IT Hosting) business. The results of operations of the disposed U.S. operations are reported as discontinued operations *(note 22)*.

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.

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

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). These consolidated financial statements were approved by the board of directors of Extendicare Inc. (the "Board") on February 28, 2018.

### b) Basis of Measurement

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

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

### c) Use of Estimates and Judgement

The preparation of 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:

- valuation of purchase price components for acquisitions *(note 6)*;
- valuation of deferred consideration *(notes 10 and 26(a))*;
- determination of the recoverable amount of cash generating units (CGUs) subject to an impairment test *(note 19)*;
- valuation of indemnification provisions *(notes 11 and 22)*;
- valuation of self-insured liabilities *(notes 11 and 22)*;
- valuation of financial assets and liabilities *(note 26(b))*;
- valuation of share-based compensation *(note 14)*; and
- accounting for tax uncertainties and the tax rates used for valuation of deferred taxes *(note 23)*.

In addition, the assessment of contingencies *(note 24)* 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. Significant Accounting Policies

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

### a) Basis of Consolidation

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

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

### b) Foreign Currency

#### Foreign Operations

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

#### Foreign Currency Transactions

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

### c) Cash and Short-term Investments

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

### d) Property and Equipment

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

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

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

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

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

The Company acquires in-place leases in connection with the acquisitions of operating retirement communities. These assets are stated at the amounts determined upon acquisition and are amortized on a straight-line basis, based upon a review of the residents' average length of stay. In-place leases are a component of building, and are generally depreciated over a three-year period.

| | |
|---|---|
| Land improvements | 10 to 25 years |
| Buildings: | |
| Building components: | |
| Structure and sprinklers systems | 50 years |
| Roof, windows and elevators | 25 years |
| HVAC and building systems | 15 to 25 years |
| Flooring and interior upgrades | 5 to 15 years |
| In-place leases | 1 to 3 years |
| Building improvements and extensions | 5 to 30 years |
| Furniture and equipment: | |
| Furniture and equipment | 5 to 15 years |
| Computer equipment | 3 to 5 years |
| Leasehold improvements | Term of the lease and renewal that is reasonably certain to be exercised |

## e) Government Grants

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

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

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

## f) Leases

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

### When the Company is the Lessee

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

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

### When the Company is the Lessor

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

## g) Goodwill and Other Intangible Assets

### Goodwill

Goodwill represents the excess amount of consideration given over the fair value of the underlying net assets acquired in a business combination, and is measured at cost less accumulated impairment losses. Goodwill is not amortized, but is tested for impairment on an annual basis or more frequently if there are indicators that goodwill may be impaired, see *note 3(h)*.

### Other Intangible Assets

Other intangible assets that are acquired are recorded at fair value determined upon acquisition, and if the assets have finite useful lives are measured at cost less accumulated amortization and accumulated impairment losses (refer to *note 3(h)*). Intangible assets with finite

lives are amortized based on cost. Subsequent expenditures are capitalized only if a future benefit exists. All other expenditures, including expenditures on internally generated goodwill, are recognized in net earnings as incurred.

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

Customer relationships acquired in connection with the purchase of a Canadian home health care business represent the intangible asset underlying the various contracts in the business. These assets are being amortized over the estimated useful lives over 15 years.

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

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

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

## h) Impairment

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

### Non-financial Assets

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

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

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

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

### Financial Assets

A financial asset *(note 3(m))* is any asset that consists of: cash; a contractual right to receive cash or another financial asset, or exchange financial assets or financial liabilities under potentially favourable conditions; an equity instrument of another entity; or certain contracts that will or may be settled in the Company's own equity instruments.

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

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

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

## i) Employee Benefits

### Defined Benefit Plans

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

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

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

### Defined Contribution Plans

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

### Short-term Employee Benefits

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

## j) Share-Based Compensation

### Cash-settled Share Appreciation Rights Plan

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

### Equity-settled Long-term Incentive Plan

Awards for deferred share units (DSUs) and performance share units (PSUs) are a share-based component of executive and director compensation, which are accounted for based on the intended form of settlement. Under a long-term incentive plan (LTIP) *(note 14)*, the Board has the discretion to settle the DSU and PSU awards in cash, market-purchased Common Shares, or Common Shares issued from treasury. Based on the Board's intention to settle the awards in Common Shares issued from treasury, the PSU and DSU awards are accounted for as equity-settled awards. Settlement of the DSUs and PSUs will be net of any applicable taxes and other source deductions required to be withheld by the Company, which amounts are anticipated to approximate 50% of the fair value of the award on the redemption date. The compensation expense for these equity-settled awards is prorated over the vesting or performance period, with a corresponding increase to contributed surplus. The fair value of each award is measured at the grant date. Forfeitures are estimated at the grant date and are revised to reflect changes in expected or actual forfeitures. In addition, PSU and DSU participants will be credited with dividend equivalents in the form of additional units when dividends are paid on Common Shares in the ordinary course of business.

## k) Provisions

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

### Self-insured Liabilities

Prior to the U.S. Sale Transaction, Extendicare self-insured certain risks related to general and professional liability. As a result of the U.S. Sale Transaction *(note 22)*, the Company no longer self-insures, but retained the associated obligation relating to the self-insured liabilities. The accrual for self-insured liabilities includes the estimated costs of both reported claims and claims incurred but not yet reported. The provision for self-insured liabilities is based on estimates of loss based upon assumptions made by management supported by actuarial projections and the advice of external risk management and legal counsel. The accrual for self-insured liabilities is discounted based on the projected timing of future payment obligations.

### Decommissioning Provisions

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

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

### Indemnification Provisions

Indemnification provisions include management's best estimate of amounts required to indemnify for obligations related to tax, a corporate integrity agreement (CIA), and other items, resulting from the U.S. Sale Transaction.

### Other Provisions

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

## l) Fair Value Measurement

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

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

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

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

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

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

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

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

## m) Financial Instruments

### Financial Assets and Liabilities

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

***Held-to-maturity Financial Assets***

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

***Loans and Receivables***

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

***Financial Assets at Fair Value Through Profit and Loss***

Assets classified as FVTPL are financial assets that are acquired for the purpose of selling in the short term. These assets are initially recognized and subsequently carried at fair value with changes recorded in net earnings and all transaction costs are expensed as incurred. We currently do not have any financial assets classified as FVTPL.

***Assets Held For Sale***

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

***Financial Liabilities***

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

The Company previously had convertible debentures that could be converted to Common Shares at the option of the holder and the number of Common Shares to be issued did not vary with changes in fair value. Convertible debentures that were issued prior to the Company being converted from an income trust effective July 1, 2012, were designated as financial liabilities valued at FVTPL, whereas those issued subsequently had the debt and equity components bifurcated with the debt component classified as other financial liabilities and the component attributable to the conversion option classified as equity. We currently do not have any financial liabilities valued at FVTPL.

***Summary of Financial Instruments and Classification***

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

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

| | Classification | Measurement |
|---|---|---|
| Cash and short-term investments | Loans and receivables | Amortized cost |
| Total receivables | Loans and receivables | Amortized cost |
| Notes, mortgages and amounts receivable | Loans and receivables | Amortized cost |
| Investments held for self-insured liabilities | AFS | Fair value |
| Interest rate swaps | FVTPL | Fair value |
| Accounts payable and accrued liabilities | Other financial liabilities | Amortized cost |
| Long-term debt | Other financial liabilities | Amortized cost |

## Derivative Financial Instruments

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

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

## n) Revenue

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

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

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

In the United States, Extendicare offered information technology services to smaller long-term and post-acute health care providers through its U.S. IT Hosting business prior to its sale at the end of 2016. This revenue source was primarily derived from application hosting, customer support, telecommunications, equipment sales and consulting services, and was recognized as these services were provided and equipment was delivered to our customers.

## o) Finance Costs and Finance Income

Finance costs include: interest expense on long-term debt; accretion of the discount on provisions, decommissioning provisions and convertible debentures; losses on the change in fair value of financial liabilities designated as FVTPL (refer to *note 3(m)*); and losses in foreign exchange on non-Canadian based financial assets.

Finance income includes interest income on funds invested, gains on the change in fair value of financial liabilities designated as FVTPL, accretion on deferred consideration and gains/losses in foreign exchange on non-Canadian based financial assets.

## p) Income Taxes

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

Current income tax is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the jurisdictions in which we operate. Deferred income tax is calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

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

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

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

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

### q) Discontinued Operations

A discontinued operation is a component of the Company's business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale. Classification as a discontinued operation occurs upon disposal or earlier, if the operation meets the criteria to be classified as held for sale. When an operation is classified as a discontinued operation, the comparative statements of earnings and cash flow information is re-presented as if the operation had been discontinued from the start of the comparative period. The U.S. business and senior care operations that were sold on July 1, 2015, as well as the U.S. IT Hosting operations that were sold on December 22, 2016, were classified as discontinued operations.

## 4. New Accounting Policies Adopted

Effective January 1, 2017, Extendicare adopted two new accounting amendments issued by the IASB: IFRS 2 "Share-based Payment", and IAS 12 "Recognition of Deferred Tax Assets for Unrealized Losses", both of which are summarized below.

### Classification and Measurement of Share-based Payment Transactions

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

### Recognition of Deferred Tax Assets for Unrealized Losses

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

## 5. Future Changes in Accounting Policies

The following new standards, amendments to standards and interpretations are effective for future annual periods, and have not been applied in preparing the financial results for the year ended December 31, 2017.

### Revenue Recognition

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

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

### Financial Instruments

On July 24, 2014, an amendment to IFRS 9 "Financial Instruments" (IFRS 9) was issued, which addresses the classification, measurement (including impairment) and recognition of financial assets and financial liabilities. The standard is effective for annual periods beginning on or after January 1, 2018, and is to be applied retrospectively.

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

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

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

### 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. IFRS 16 is effective for periods beginning on or after January 1, 2019, with earlier adoption permitted if IFRS 15 "Revenue from Contracts with Customers" has also been applied. The Company does not plan to early adopt IFRS 16, and is in the process of performing its initial assessment of the potential impact of this standard on its consolidated financial statements. The Company expects to disclose additional detailed information, including its transition method, any practical expedients elected and estimated quantitative financial effects, prior to the adoption of IFRS 16.

## 6. Acquisitions

During the 2015 fourth quarter and 2016 first quarter, the Company completed acquisitions of six retirement communities, all of which are accounted for as business combinations. The purchase price allocations for all these acquisitions were finalized in 2016. These six retirement communities contributed revenue and net operating income of $19.1 million, and $3.0 million, respectively, for the year ended December 31, 2017, and revenue and net operating income of $15.5 million, and $1.0 million, respectively, for the year ended December 31, 2016.

## 7. Accounts Receivable

| | **2017** | 2016 |
|---|---|---|
| Trade receivables | **33,466** | 40,832 |
| Retroactive rate accruals | **–** | 585 |
| Other receivables | **9,025** | 10,817 |
| **Accounts receivable – net of allowance** *(note 26(a))* | **42,491** | 52,234 |

## 8. Property and Equipment

| | Land & Land Improvements | Buildings | Furniture & Equipment | Leasehold Improvements | Construction in Progress | Total |
|---|---|---|---|---|---|---|
| **Cost or Deemed Cost** | | | | | | |
| January 1, 2016 | 45,345 | 478,238 | 82,699 | 2,186 | 15,906 | 624,374 |
| Additions | 309 | 3,254 | 6,339 | 113 | 29,607 | 39,622 |
| Acquisitions *(note 6)* | 2,000 | 32,500 | 1,500 | – | – | 36,000 |
| Government funding subsidy *(note 10)* | – | 3,105 | – | – | – | 3,105 |
| Disposals | (279) | (7,314) | (20,172) | (187) | – | (27,952) |
| Write-off of fully-depreciated assets | (98) | (4,037) | (7,380) | (152) | – | (11,667) |
| Transfers | 1,305 | 13,416 | 1,112 | 437 | (16,177) | 93 |
| Effect of movements in exchange rates | (7) | (190) | (467) | (2) | – | (666) |
| **December 31, 2016** | 48,575 | 518,972 | 63,631 | 2,395 | 29,336 | 662,909 |
| Additions | **185** | **3,228** | **3,654** | **108** | **34,634** | **41,809** |
| Write-off of fully-depreciated assets | **(180)** | **(4,487)** | **(4,834)** | **(124)** | **–** | **(9,625)** |
| Transfers | **2,548** | **26,797** | **2,637** | **(42)** | **(32,176)** | **(236)** |
| **December 31, 2017** | **51,128** | **544,510** | **65,088** | **2,337** | **31,794** | **694,857** |

| | Land & Land Improvements | Buildings | Furniture & Equipment | Leasehold Improvements | Construction in Progress | Total |
|---|---|---|---|---|---|---|
| **Accumulated Depreciation** | | | | | | |
| January 1, 2016 | 3,307 | 149,247 | 44,457 | 1,172 | – | 198,183 |
| Additions | 524 | 19,759 | 7,145 | 454 | – | 27,882 |
| Disposals | – | (2,337) | (14,200) | (37) | – | (16,574) |
| Write-off of fully-depreciated assets | (98) | (4,037) | (7,380) | (152) | – | (11,667) |
| Effect of movements in exchange rates | – | (53) | (294) | (1) | – | (348) |
| **December 31, 2016** | 3,733 | 162,579 | 29,728 | 1,436 | – | 197,476 |
| Additions | **543** | **19,890** | **6,102** | **485** | **–** | **27,020** |
| Write-off of fully-depreciated assets | **(180)** | **(4,487)** | **(4,834)** | **(124)** | **–** | **(9,625)** |
| Transfers | **–** | **(54)** | **17** | **55** | **–** | **18** |
| **December 31, 2017** | **4,096** | **177,928** | **31,013** | **1,852** | **–** | **214,889** |
| **Carrying amounts** | | | | | | |
| At December 31, 2016 | 44,842 | 356,393 | 33,903 | 959 | 29,336 | 465,433 |
| **At December 31, 2017** | **47,032** | **366,582** | **34,075** | **485** | **31,794** | **479,968** |

The cost of assets included in property and equipment under finance leases was $81.5 million (2016 – $82.7 million) with accumulated depreciation of $30.3 million (2016 – $28.9 million) *(note 12)*.

During 2017, the Company capitalized $1.2 million of borrowing costs related to development projects under construction at an average capitalization rate of 5.3% (2016 – $1.0 million at 6.0%). Building additions included $0.7 million related to a change in the decommissioning provisions *(note 11)*.

## 9. Goodwill and Other Intangible Assets

| | **2017** | 2016 |
|---|---|---|
| **Goodwill** | | |
| Balance at beginning of year | **51,675** | 53,381 |
| Impairment *(note 19)* | **–** | (1,672) |
| Disposal | **–** | (33) |
| Effect of movements in exchange rates | **–** | (1) |
| Balance at end of year | **51,675** | 51,675 |
| **Other Intangible Assets** | | |
| Gross carrying value at beginning of year | **46,000** | 48,724 |
| Additions | **10,490** | 194 |
| Write-off of fully amortized assets | **(35)** | (98) |
| Disposals | **–** | (2,752) |
| Effect of movements in exchange rates | **–** | (68) |
| Gross carrying value at end of year | **56,455** | 46,000 |
| Accumulated amortization at beginning of year | **7,905** | 5,751 |
| Amortization | **4,359** | 4,482 |
| Write-off of fully amortized assets | **(35)** | (98) |
| Disposal | **–** | (2,179) |
| Effect of movements in exchange rates | **–** | (51) |
| Accumulated amortization at end of year | **12,229** | 7,905 |
| Net carrying value | **44,226** | 38,095 |
| **Goodwill and other intangible assets** | **95,901** | 89,770 |

## 10. Other Assets

| | **2017** | 2016 |
|---|---|---|
| Investments held for self-insured liabilities | **86,296** | 136,109 |
| Amounts receivable and other assets | **74,625** | 84,443 |
| Deferred consideration | **–** | 37,429 |
| Interest rate swaps *(note 12)* | **3,459** | 985 |
| | **164,380** | 258,966 |
| less: current portion | **20,634** | 25,251 |
| | **143,746** | 233,715 |

### Investments Held for Self-insured Liabilities

Extendicare holds investments within the Captive for self-insured liabilities that are subject to insurance regulatory requirements *(note 11)*.

The investment portfolio comprises U.S. dollar-denominated cash and money market funds of $75.1 million (2016 – $112.4 million), and investment-grade corporate and government securities of $11.2 million (2016 – $23.7 million). Certain of these investments in the amount of $45.4 million (US$36.1 million) (2016 – $83.8 million or US$62.4 million), have been pledged as collateral for letters of credit issued by the banker of the Captive in favour of ceding companies. The decline in the investment portfolio included the transfer of US$16.0 million in 2017 to the Company for general corporate use. As at December 31, 2017, all investments were categorized as available for sale and carried at fair value.

### 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 $58.5 million (2016 – $63.5 million) of which $5.2 million (2016 – $4.9 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.

In the 2016 first quarter, the Company received an additional subsidy in connection with two centres and recorded the present value of the additional funding totalling $6.4 million. The construction funding subsidies have been discounted at rates ranging from 3.27% to 6.5%, with the values being recorded as a reduction in the cost of the property and equipment related to the centres. The accretion of the note receivable is recognized in interest revenue as part of net finance costs.

Also included in amounts receivable and other assets is a $2.8 million receivable as at December 31, 2017 (2016 – $8.3 million), resulting from the U.S. Sale Transaction *(note 22)*, as well as prepaid expenses and deposits.

### 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. Subsequent to the 2017 second quarter, the Company received notice that the operator of the Leased Centres had failed to make its required minimum lease payments. As a result of this event and related discussions, the Company does not expect to receive any further amounts and has written off the balance of the deferred consideration of US$27.9 million, resulting in a charge of $37.5 million in the second quarter *(note 22)*.

## 11. Provisions

| | Accrual for Self-insured Liabilities | Indemnification Provisions | Decommissioning Provisions | Total |
|---|---|---|---|---|
| January 1, 2016 | 148,429 | 31,879 | 7,806 | 188,114 |
| Provisions recorded (released) | (16,818) | 2,661 | (18) | (14,175) |
| Provisions used | (32,976) | (5,030) | – | (38,006) |
| Accretion | 1,325 | – | 349 | 1,674 |
| Effect of movements in exchange rates | (5,119) | (1,063) | – | (6,182) |
| **December 31, 2016** | 94,841 | 28,447 | 8,137 | 131,425 |
| Less: current portion | 31,419 | – | – | 31,419 |
| | 63,422 | 28,447 | 8,137 | 100,006 |
| January 1, 2017 | **94,841** | **28,447** | **8,137** | **131,425** |
| Provisions recorded (released) | **(5,718)** | **4,885** | **699** | **(134)** |
| Provisions used | **(24,160)** | **(8,817)** | **–** | **(32,977)** |
| Accretion | **1,283** | **–** | **349** | **1,632** |
| Effect of movements in exchange rates | **(5,111)** | **(1,836)** | **–** | **(6,947)** |
| **December 31, 2017** | **61,135** | **22,679** | **9,185** | **92,999** |
| Less: current portion | **22,659** | **7,278** | **–** | **29,937** |
| | **38,476** | **15,401** | **9,185** | **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 10)* 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, including the Company, 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 believes to be adequate based upon the nature and risks of its business, historical experience and industry standards, along with the type of insurance coverage commercially available in the marketplace.

The accrual for self-insured liabilities is based on management's best estimate of the ultimate cost to resolve general and professional liability claims, including both known claims and claims that have been incurred but not yet reported by the end of the reporting period. 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 December 31, 2017, the accrual for self-insured general and professional liabilities was $61.1 million (US$48.6 million) compared to $94.8 million (US$70.6 million) at the beginning of the year. The decline of $33.7 million represented claim payments of $24.2 million (US$18.6 million), the release of reserves of $5.7 million (US$4.4 million), reflected as other expense (income) in discontinued operations, and foreign exchange of $5.1 million, partially offset by accretion of $1.3 million (US$1.0 million).

### Indemnification Provisions

As a result of the U.S. Sale Transaction *(note 22)*, the Company has 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 *(note 22)*. As at December 31, 2017, the remaining provisions totalled $22.7 million (US$18.0 million) (2016 – $28.4 million or US$21.2 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 *(note 3(k))*. 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.

## 12. Long-term Debt

| | Interest Rate | Year of Maturity | **2017** | 2016 |
|---|---|---|---|---|
| **Canadian Operations** | | | | |
| Convertible unsecured subordinated debentures | 6.0% | 2019 | **124,800** | 123,912 |
| CMHC mortgages | 2.93% – 7.7% | 2018 – 2037 | **123,911** | 138,305 |
| Non-CMHC mortgages | 3.11% – 5.637% | 2020 – 2038 | **172,844** | 145,750 |
| Construction loans | BA + 2.5% | on demand | **29,868** | 12,605 |
| Finance lease obligations | 2.69% – 7.19% | 2018 – 2028 | **90,323** | 89,738 |
| | | | **541,746** | 510,310 |
| Financing costs | | | **(5,678)** | (6,742) |
| Total debt, net of financing costs | | | **536,068** | 503,568 |
| Less: current portion | | | **59,664** | 54,826 |
| **Long-term debt, net of financing costs** | | | **476,404** | 448,742 |

### Canadian Operations

#### 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").

Interest on the 2019 Debentures is 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.

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

The debt and equity components of the 2019 Debentures were bifurcated as the financial instrument is considered a compound instrument with $120.7 million classified as a liability and the residual $5.8 million classified as equity attributable to the conversion option. The liability portion of the 2019 Debentures is recorded at amortized cost. The fees and transaction costs allocated to the debt component are amortized over the term of the 2019 Debentures using the effective interest method and recognized as part of net finance costs.

#### CMHC Mortgages

Extendicare's Canadian subsidiaries have various mortgages insured through the Canada Mortgage and Housing Corporation (CMHC) program. The CMHC mortgages are secured by several Canadian financial institutions at rates ranging from 2.93% to 7.7% with maturity dates through to 2037.

During the 2017 first quarter, one of the mortgages in the amount of $5.8 million, which matured in October 2016, was renewed at 3.04% to mature in November 2026. In addition, two mortgages totalling $16.5 million, which matured in February 2017, were renewed under the existing CMHC certificate at a rate of 3.35% to mature in February 2032.

#### Non-CMHC Mortgages

The Canadian operations have a number of conventional mortgages on certain long-term care centres, at rates ranging from 3.27% to 5.637%. Some of these mortgages have a requirement to maintain a minimum debt service coverage ratio. In May 2017, the Company secured a $30.0 million term loan with the Canadian Imperial Bank of Commerce (the "CIBC Term Loan") upon maturity of $3.6 million of existing mortgages on nine Alberta long-term care centres. The CIBC Term Loan bears an interest rate based on a variable 30-day banker's acceptance rate plus 1.8% for a term of five years to May 2022, with principal and interest payable in monthly installments based on a 20-year amortization. The maximum borrowing base under the CIBC Term Loan will be determined annually based upon the aggregate of the updated lending value established for each property. The Company entered into an interest rate swap contract to lock in the rate at 3.27% for the full term.

In addition, in August 2016, the Company secured financing on three of the acquired retirement communities, representing non-revolving credit facilities aggregating $56.3 million. These financings have seven-year terms, with a floating rate of prime plus 0.5% or banker's acceptance (BA) plus 1.9%. In conjunction with securing these credit facilities, the Company entered into interest rate swap contracts to lock in the interest rates at 3.11% for the full terms of these credit facilities.

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 20)*. As at December 31, 2017, the interest rate swaps were valued as an asset of $3.5 million, which is included as part of other assets *(note 10)*.

### 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 December 31, 2017, an aggregate of $29.9 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 December 31, 2017 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.

Finance lease obligations are payable as follows:

| | | | **2017** | | | 2016 |
|---|---|---|---|---|---|---|
| | **Future Minimum Lease Payments** | **Interest** | **Present Value of Minimum Lease Payments** | Future Minimum Lease Payments | Interest | Present Value of Minimum Lease Payments |
| Less than one year | **14,256** | **5,741** | **8,515** | 12,104 | 6,002 | 6,102 |
| Between one and five years | **53,353** | **17,489** | **35,864** | 48,416 | 19,335 | 29,081 |
| More than five years | **53,488** | **7,544** | **45,944** | 65,593 | 11,038 | 54,555 |
| | **121,097** | **30,774** | **90,323** | 126,113 | 36,375 | 89,738 |

## Other

### Credit Facility

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 December 31, 2017, Extendicare had letters of credit totalling approximately $43.8 million issued under the RBC Credit Facility, of which $39.9 million secure our defined benefit pension plan obligations and the balance were issued in connection with obligations relating to recently acquired centres and those centres under development. The letter of credit to secure the pension plan obligations renews annually based on an actuarial valuation. The unutilized portion of the credit facility was $3.5 million as at December 31, 2017. 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 December 31, 2017.

### Restricted Cash

In connection with certain financing, funds totalling $2.3 million as at December 31, 2017 (2016 – $2.2 million), included in restricted cash are designated for future capital expenditures.

### 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 $1.1 million in 2017 related to the amortization of finance costs, offset in part by incremental costs of $0.6 million related primarily to the refinancing of the CIBC Term Loan.

Below is a summary of the deferred financing costs:

| | **2017** | 2016 |
|---|---|---|
| **Canadian Operations** | | |
| Convertible unsecured subordinated debentures | **1,387** | 2,180 |
| CMHC mortgages | **2,465** | 2,877 |
| Non-CMHC mortgages | **1,595** | 1,415 |
| Finance lease obligations | **231** | 270 |
| Total financing costs | **5,678** | 6,742 |
| Less: current portion | **1,463** | 1,636 |
| | **4,215** | 5,106 |

### Principal Repayments

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

| Year | Amount |
|---|---|
| 2018 | 52,612 |
| 2019 | 140,448 |
| 2020 | 58,463 |
| 2021 | 13,478 |
| 2022 | 55,781 |
| 2023 and beyond | 132,341 |
| | 453,123 |

### Interest Rates

The weighted average interest rate of all long-term debt at December 31, 2017, was approximately 5.0% (2016 – 5.2%). At December 31, 2017, 94.5% of the long-term debt, including interest rate swaps, was at fixed rates (2016 – 97.5%).

## 13. Other Long-term Liabilities

| | **2017** | 2016 |
|---|---|---|
| Accrued pension plan obligation *(note 25)* | **34,072** | 34,784 |
| Share appreciation rights *(note 14)* | **–** | 846 |
| Other | **950** | 409 |
| | **35,022** | 36,039 |

## 14. Share-based Compensation

The Company's share-based compensation, which includes SARs, DSUs and PSUs, was an expense of $2.0 million for each of 2017 and 2016.

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

| | **2017** | 2016 |
|---|---|---|
| Accounts payable and accrued liabilities – SARs | **1,146** | 822 |
| Other long-term liabilities – SARs | **–** | 846 |
| Contributed surplus – DSUs | **1,220** | 552 |
| Contributed surplus – PSUs | **1,217** | 389 |

## 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:

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **Share Appreciation Rights** | **Weighted Average Vesting Price** | Share Appreciation Rights | Weighted Average Vesting Price |
| Outstanding, beginning of year | **597,000** | **$ 7.05** | 774,111 | $ 6.93 |
| Vested | **(216,000)** | **6.88** | (177,111) | 6.52 |
| Forfeited | **(9,000)** | **7.69** | – | – |
| **Outstanding, end of year** | **372,000** | **$ 7.14** | 597,000 | $ 7.05 |
| Average remaining contractural life | **0.2 years** | | 0.9 years | |

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

| | **2017** | 2016 |
|---|---|---|
| Share price | **9.11** | 9.96 |
| Volatility | **14.00%** | 20.00% |
| Risk-free interest rate | **1.00% – 1.21%** | 0.56% – 0.69% |
| Strike price | **$6.55 – $7.69** | $6.52 – $7.69 |
| Expected remaining life | **0.1 years – 0.4 years** | 0.4 years – 1.4 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. None of the PSUs had vested as at December 31, 2017. An aggregate of 4,407,892 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 | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| Units outstanding, beginning of period | **61,124** | – | **173,550** | – |
| Granted | **72,742** | 59,967 | **173,329** | 167,343 |
| Reinvested dividend equivalents | **4,137** | 1,157 | **10,616** | 6,207 |
| Forfeited | **–** | – | **(14,551)** | – |
| Settled | **(3,634)** | – | **–** | – |
| **Units outstanding, end of period** | **134,369** | 61,124 | **342,944** | 173,550 |
| Weighted average fair value of units granted during the period at grant date | **$ 9.68** | $ 9.21 | **$ 11.63** | $ 9.81 |

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:

| | Twelve months ended December 31, 2017 | | Twelve months ended December 31, 2016 |
|---|---|---|---|
| Grant date | **March 15, 2017** | **May 25, 2017** | April 7, 2016 |
| Vesting date | **March 15, 2020** | **May 25, 2020** | April 7, 2019 |
| PSUs granted | **160,689** | **12,640** | 167,343 |
| Fair value of AFFO component | **$ 5.24** | **$ 5.11** | $ 4.80 |
| Fair value of TSR component | **6.42** | **6.12** | 5.01 |
| Grant date fair value | **$ 11.66** | **$ 11.23** | $ 9.81 |
| Expected volatility of Extendicare's Common Shares | **23.09%** | **24.90%** | 23.19% |
| Expected volatility of the Index | **13.41%** | **13.60%** | 12.89% |
| Risk-free rate | **0.92%** | **0.75%** | 0.52% |
| Dividend yield | **nil** | **nil** | nil |

## 15. Share Capital

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | ***Shares*** | **Amount** | *Shares* | Amount |
| Balance at beginning of year | ***88,684,485*** | **$489,656** | *87,953,291* | $483,385 |
| Transactions with shareholders | | | | |
| DRIP | ***535,025*** | **5,081** | *731,194* | 6,271 |
| Purchase of shares for cancellation in excess of book value | ***(696,220)*** | **(3,856)** | – | – |
| **Balance at end of year** | ***88,523,290*** | **$490,881** | *88,684,485* | $489,656 |

### Authorized Capital

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

#### Common Shares

Each Common Share is transferable and represents an equal and undivided beneficial interest in the assets of the Company. Each Common Share entitles the holder to one vote at all meetings of shareholders of the Company. Shareholders are entitled to receive dividends from the Company if, as and when declared by the Board. During 2017 and 2016, the Company declared cash dividends of $0.48 per share.

#### Preferred Shares

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

### Distribution Reinvestment Plan

The Company has a Distribution Reinvestment Plan (DRIP) pursuant to which shareholders who are residents in Canada may elect to reinvest their cash distributions in additional Common Shares on the date of the distribution, at a price equal to 97% of the volume-weighted average trading price of the Common Shares on the TSX for the five trading days immediately preceding the corresponding date of distribution. During 2017, the Company issued 0.5 million Common Shares at a value of $5.1 million in connection with the DRIP (2016 – $0.7 million Common Shares at a value of $6.3 million).

### Normal Course Issuer Bid

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

On January 10, 2018, Extendicare received the approval of the TSX to renew its normal course issuer bid (the "Bid") to purchase for cancellation up to 8,770,000 Common Shares (approximately 10% of the public float) through the facilities of the TSX, and on alternative Canadian trading 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 February 28, 2018, the Company has acquired and cancelled 352,233 Common Shares under the Bid at an average price of $8.94 per share, for a total cost of $3.1 million, all of which were acquired in January 2018.

## 16. Equity Reserves

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

| | Unrealized Gains/Losses on AFS Securities | Realized Gains/ Losses on AFS Securities Transferred to Net Earnings | Total Fair Value Reserve | Translation Reserve | Total Equity Reserves |
|---|---|---|---|---|---|
| Balance, January 1, 2016 | 7,920 | (4,571) | 3,349 | 6,738 | 10,087 |
| Reclassed to gain on sale of U.S. IT Hosting operations | – | – | – | (1,431) | (1,431) |
| Recognized during the year | 5,574 | (2,532) | 3,042 | (1,532) | 1,510 |
| **Balance, December 31, 2016** | 13,494 | (7,103) | 6,391 | 3,775 | 10,166 |
| Recognized during the year | **4,955** | **(7,012)** | **(2,057)** | **(3,097)** | **(5,154)** |
| **Balance, December 31, 2017** | **18,449** | **(14,115)** | **4,334** | **678** | **5,012** |

### Fair Value Reserve

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale financial assets until the investments are derecognized, at which time, the cumulative change in fair value is recognized in net earnings.

### Translation Reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations until the operations are derecognized, at which time, the cumulative change in foreign currency differences are recognized in net earnings. During 2016, $1.4 million was reclassified to the gain on the sale of the U.S. IT Hosting operations *(note 22)*.

## 17. Revenue

| | **2017** | 2016 |
|---|---|---|
| Long-term care | **616,887** | 608,618 |
| Retirement living | **20,673** | 15,474 |
| Home health care | **435,718** | 414,406 |
| Management, consulting and other | **24,053** | 22,260 |
| **Total revenue** | **1,097,331** | 1,060,758 |

Funding received by Extendicare for its long-term care centres and home health care services is regulated by provincial authorities. Revenue from provincial programs represented approximately 70% of Extendicare's long-term care revenue (2016 – 70%), and approximately 98% of Extendicare's home health care revenue for 2017 (2016 – 97%).

## 18. Expenses by Nature

| | **2017** | 2016 |
|---|---|---|
| Employee wages and benefits | **851,318** | 822,416 |
| Food, drugs, supplies and other variable costs | **48,566** | 44,739 |
| Property based and other costs | **93,092** | 94,018 |
| Total operating expenses and administrative costs | **992,976** | 961,173 |
| Lease costs | **6,758** | 6,650 |
| **Total expenses** | **999,734** | 967,823 |

## 19. Other Expense

| | **2017** | 2016 |
|---|---|---|
| Proxy contest costs | **–** | 1,862 |
| Acquisition costs and integration costs | **–** | 479 |
| Asset impairment | **–** | 1,672 |
| **Other expense** | **–** | 4,013 |

In 2016, the Company incurred proxy contest costs, including advisory and professional fees, of $1.9 million. In connection with acquisitions, the Company incurred advisory fees aggregating $0.5 million in 2016.

### Impairment

Goodwill of the Company arises from acquisitions, and must be assessed for impairment on an annual basis. Based upon the impairment assessment performed in 2016, the Company recognized a net pre-tax impairment loss of $1.7 million on goodwill for certain properties. There was no impairment of goodwill in 2017.

Property and equipment must be assessed for impairment when indicators of impairment exist. There was no triggering event in 2017 and 2016; therefore, there was no impairment on property and equipment for these years.

The determination of recoverable amounts can be significantly impacted by estimates related to current market valuations, current and future economic conditions in the geographical markets of each CGU, and management's strategic plans within each of its markets. Estimates and assumptions used in the determination of the impairment loss were based upon information that was known at the time, along with the future outlook. The Company completes the assessment of fair value using financial performance and current capitalization rates. The fair value is a Level 3 valuation *(note 26(b))*.

## 20. Foreign Exchange (Gain) Loss and Fair Value Adjustments

### Foreign Exchange Gain and Loss

Loss (gain) on foreign exchange include: (1) a $0.1 million unrealized foreign exchange loss related to the deferred consideration in connection with the U.S. Sale Transaction *(note 10)* (2016 – loss of $1.1 million); (2) foreign exchange losses of $0.7 million on balances remaining related to the U.S. Sale Transaction that are denominated in U.S. dollars, $1.3 million of which were unrealized (2016 – losses of $0.8 million, most of which were unrealized) *(note 22)*; and (3) a foreign exchange gain of $1.6 million on funds repatriated from the Captive (2016 – gain of $0.7 million) *(note 10)*.

### Fair Value Adjustment on Interest Rate Swaps

The Company entered into interest rate swap contracts in August 2016 and May 2017 to lock in the interest rates for certain mortgages. The fair value of these contracts as at December 31, 2017, resulted in a gain of $2.5 million for 2017 (2016 – gain of $1.0 million) *(notes 10 and 12)*.

## 21. Earnings per Share

Basic earnings (loss) per share (EPS) is calculated by dividing the net earnings (loss) 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 (loss) 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.

| | **2017** | 2016 |
|---|---|---|
| **Numerator for Basic and Diluted Earnings per Share** | | |
| *Earnings from continuing operations* | | |
| Net earnings for basic earnings per share | **2,132** | 35,452 |
| Less: Earnings (loss) from discontinued operations, net of tax | **(29,580)** | 4,035 |
| Earnings from continuing operations for basic earnings per share | **31,712** | 31,417 |
| Add: after-tax interest on convertible debt | **7,342** | 7,086 |
| Earnings from continuing operations for diluted earnings per share | **39,054** | 38,503 |
| *Net earnings* | | |
| Net earnings for basic earnings per share | **2,132** | 35,452 |
| Add: after-tax interest on convertible debt | **7,342** | 7,086 |
| Net earnings for diluted earnings per share | **9,474** | 42,538 |

| | **2017** | 2016 |
|---|---|---|
| **Denominator for Basic and Diluted Earnings per Share** | | |
| Actual weighted average number of shares | **88,720,572** | 88,349,331 |
| Vested equity-settled compensation | **84,786** | 22,712 |
| Weighted average number of shares for basic earnings per share | **88,805,358** | 88,372,043 |
| Shares issued if all convertible debt was converted | **11,244,444** | 11,244,444 |
| Dilutive effect of equity-settled compensation | **38,121** | 7,646 |
| Total for diluted earnings per share | **100,087,923** | 99,624,133 |
| **Basic and Diluted Earnings (Loss) per Share** *(in dollars)* | | |
| Earnings from continuing operations | **0.36** | 0.36 |
| Earnings (loss) from discontinued operations | **(0.34)** | 0.04 |
| Net earnings | **0.02** | 0.40 |

## 22. Discontinued Operations

### U.S. IT Hosting Operations

The Company's former U.S. IT Hosting operations were reclassified as discontinued in the 2016 second quarter following the decision to actively market the sale of the operations. On December 22, 2016, the Company completed the sale of substantially all of the assets used in those operations for gross cash proceeds of $11.5 million (US$8.5 million), prior to working capital adjustments and transaction costs. Net proceeds from the sale, after working capital adjustments and transaction costs, were $9.5 million (US$7.1 million). The sale resulted in a pre-tax loss of $8.6 million (after-tax loss of $8.4 million), and included a working capital adjustment of $0.3 million and the realization of a foreign currency translation adjustment of $1.4 million that was previously included in AOCI.

## U.S. Sale Transaction

The proceeds from the U.S. Sale Transaction included an element of deferred consideration. At June 30, 2017, the remaining balance was written off resulting in a charge of $37.5 million in the 2017 second quarter *(note 10)*. In addition, 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 December 31, 2017, the Company had remaining provisions totalling $22.7 million (US$18.0 million) *(note 11)*, and a receivable of $2.8 million (US$2.2 million) *(note 10)* (2016 – provisions of $28.4 million and receivable of $8.3 million). Changes in the estimates of indemnification provisions and receivables are reflected as other expense (income) in the results of discontinued operations outlined below. The unfavourable changes in 2017, were primarily related to a $5.1 million increase of estimated cost of the CIA in the second quarter. Favourable changes were $2.7 million for 2016. Other expense (income) in 2017 also includes the release of accrual for self-insured liabilities of $5.7 million or US$4.4 million (2016 – $16.8 million or US$12.7 million) *(note 11)*.

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 11)*.

## Results of Discontinued Operations

The following is a summary of results of the discontinued operations.

| | **2017** | | | 2016 |
|---|---|---|---|---|
| | **U.S. Sale Total** | U.S. IT Hosting | U.S. Sale | Total |
| Nursing and assisted living centres revenue | **–** | – | – | – |
| Health technology services revenue | **–** | 28,751 | – | 28,751 |
| Outpatient therapy revenue | **–** | – | – | – |
| Management, consulting and other | **–** | – | – | – |
| Total revenue | **–** | 28,751 | – | 28,751 |
| Operating expenses | **–** | 23,979 | – | 23,979 |
| Administrative costs | **–** | 5,055 | – | 5,055 |
| Lease costs | **–** | 621 | – | 621 |
| Total expenses | **–** | 29,655 | – | 29,655 |
| Loss before depreciation, amortization, and other expense | **–** | (904) | – | (904) |
| Depreciation and amortization | **–** | 1,185 | – | 1,185 |
| Other expense (income) | **36,576** | – | (22,651) | (22,651) |
| Earnings (loss) before net finance costs and income taxes | **(36,576)** | (2,089) | 22,651 | 20,562 |
| Net finance costs | **–** | 16 | – | 16 |
| Earnings (loss) before income taxes | **(36,576)** | (2,105) | 22,651 | 20,546 |
| Income tax expense (recovery) | **(6,996)** | (50) | 8,103 | 8,053 |
| Earnings (loss) from discontinued operations, before loss on sale of U.S. operations | **(29,580)** | (2,055) | 14,548 | 12,493 |
| Loss on sale of U.S. operations, net of income taxes | **–** | (8,458) | – | (8,458) |
| Earnings (loss) from discontinued operations | **(29,580)** | (10,513) | 14,548 | 4,035 |

| | **2017** | | | 2016 |
|---|---|---|---|---|
| | **U.S. Sale Total** | U.S. IT Hosting | U.S. Sale | Total |
| **Cash Flows from Discontinued Operations** | | | | |
| Net cash from operating activities | **(24,160)** | 575 | (32,976) | (32,401) |
| Net cash from investing activities | **24,160** | 8,096 | 32,976 | 41,072 |
| Net cash from financing activities | **–** | (8,671) | – | (8,671) |
| **Effect on cash flows** | **–** | – | – | – |

## 23. Income Taxes

### Tax Recognized in Net Earnings

| | 2017 | 2016 |
|---|---|---|
| **Current Tax Expense** | | |
| Current year | **10,191** | 11,304 |
| Items related to sale of U.S. operations | **(1,230)** | 8,521 |
| Utilization of losses | **(87)** | (18) |
| Other prior year adjustments | **45** | (5,488) |
| | **8,919** | 14,319 |
| **Deferred Tax Expense (Recovery)** | | |
| Origination and reversal of temporary difference | **(4,236)** | 946 |
| Items related to sale of U.S. operations | **(451)** | (648) |
| Utilization of losses | **–** | – |
| Other prior year adjustments | **(376)** | 665 |
| | **(5,063)** | 963 |
| **Total tax expense** | **3,856** | 15,282 |
| Tax expense from continuing operations | **10,852** | 7,411 |
| Tax expense (recovery) from discontinued operations | **(6,996)** | 7,871 |
| **Total tax expense** | **3,856** | 15,282 |

Following a successful notice of objection to appeal a 2015 reassessment by the Canada Revenue Agency (CRA), the Company reversed a $3.6 million tax provision, reflected as a current income tax recovery in the 2016 fourth quarter.

### Tax Recognized in Other Comprehensive Income

| | **2017** | | | 2016 | | |
|---|---|---|---|---|---|---|
| | **Before Tax** | **Tax Expense** | **Net of Tax** | Before Tax | Tax Expense | Net of Tax |
| Foreign currency translation differences for foreign operations | **(3,097)** | **–** | **(3,097)** | (2,963) | – | (2,963) |
| Available-for-sale financial assets | **(2,057)** | **–** | **(2,057)** | 3,042 | – | 3,042 |
| Deferred benefit plan actuarial gains (losses) | **(423)** | **112** | **(311)** | 3,147 | (834) | 2,313 |
| | **(5,577)** | **112** | **(5,465)** | 3,226 | (834) | 2,392 |

### Effective Tax Rate

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

| | 2017 | 2016 |
|---|---|---|
| Earnings from continuing operations before income taxes | **42,564** | 38,828 |
| Income taxes at statutory rates of 26.5% | **11,279** | 10,289 |
| Income tax effect relating to the following items: | | |
| Tax rate variance of foreign subsidiaries | **(1,173)** | 650 |
| Non-deductible items | **1,033** | 983 |
| Non-taxable income | **(17)** | 49 |
| Prior year adjustment | **(331)** | (4,823) |
| Current year U.S. losses for which no deferred tax asset was recognized | **–** | 311 |
| Other items | **61** | (48) |
| | **10,852** | 7,411 |

## Summary of Operating and Capital Loss Carryforwards

Extendicare's Canadian corporate subsidiaries had $7.2 million of benefited net operating loss carryforwards as at December 31, 2017 (2016 – $7.3 million), which expire in the years 2035 through 2037, and capital loss carryforwards of $16.5 million (2016 – $13.8 million) which have not been tax benefited and are available indefinitely to apply against future capital gains.

Deferred tax assets recognized as at December 31, 2017, were $13.9 million (2016 – $15.3 million). Net deferred tax liabilities decreased in 2017 to $0.4 million from $5.2 million at December 31, 2016.

## Recognized Deferred Tax Assets and Liabilities

Net deferred tax liabilities comprise the following:

| | | | **2017** | | | 2016 |
|---|---|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Net** | Assets | Liabilities | Net |
| Property and equipment | **981** | **30,654** | **29,673** | 411 | 31,807 | 31,396 |
| Intangible assets | **4,408** | **217** | **(4,191)** | 7,808 | – | (7,808) |
| Other assets | **–** | **963** | **963** | – | 8,271 | 8,271 |
| Deferred financing costs | **1,833** | **1,553** | **(280)** | – | 1,840 | 1,840 |
| Accounts receivable reserves | **–** | **–** | **–** | – | 520 | 520 |
| Financial assets at fair value | **–** | **908** | **908** | – | 264 | 264 |
| Self–insurance reserves | **276** | **–** | **(276)** | 256 | – | (256) |
| Indemnification provisions | **7,939** | **–** | **(7,939)** | 9,957 | – | (9,957) |
| Employee benefit accruals | **10,013** | **–** | **(10,013)** | 10,405 | – | (10,405) |
| Operating loss carryforwards | **1,922** | **–** | **(1,922)** | 1,964 | – | (1,964) |
| Deferred revenue | **4,380** | **42** | **(4,338)** | 4,564 | 127 | (4,437) |
| Decommissioning provision | **2,248** | **–** | **(2,248)** | 2,157 | – | (2,157) |
| Other | **248** | **336** | **88** | 281 | 193 | (88) |
| Set-off of tax | **(20,357)** | **(20,357)** | **–** | (22,456) | (22,456) | – |
| | **13,891** | **14,316** | **425** | 15,347 | 20,566 | 5,219 |

Deferred income taxes are provided for temporary differences between the carrying values of assets and liabilities and their respective tax values as well as available tax loss carryforwards. Management believes it is more likely than not that Extendicare's corporate subsidiaries will realize the benefits of these deductible differences.

The significant components of deferred income tax assets and liabilities and the movement in these balances during the year were as follows:

| | **Balance January 1 2017** | **Recognized in Net Earnings** | **Recognized in Other Comprehensive Income/Other** | **Recognized in Discontinued Operations** | **Change in Foreign Exchange** | **Balance December 31 2017** |
|---|---|---|---|---|---|---|
| Property and equipment | **31,396** | **(1,723)** | **–** | **–** | **–** | **29,673** |
| Other assets | **8,271** | **95** | **–** | **(7,120)** | **(283)** | **963** |
| Deferred financing costs | **1,840** | **(2,120)** | **280** | **–** | **–** | **–** |
| Accounts receivable reserves | **520** | **(520)** | **–** | **–** | **–** | **–** |
| Financial assets at fair value | **264** | **644** | **–** | **–** | **–** | **908** |
| Self-insurance reserves | **(256)** | **(20)** | **–** | **–** | **–** | **(276)** |
| Indemnification provisions | **(9,957)** | **–** | **–** | **1,354** | **664** | **(7,939)** |
| Intangible assets | **(7,808)** | **3,617** | **–** | **–** | **–** | **(4,191)** |
| Employee benefit accruals | **(10,405)** | **504** | **(112)** | **–** | **–** | **(10,013)** |
| Operating loss carryforwards | **(1,964)** | **42** | **–** | **–** | **–** | **(1,922)** |
| Deferred revenue | **(4,437)** | **99** | **–** | **–** | **–** | **(4,338)** |
| Accounts receivable reserves | **–** | **–** | **(280)** | **–** | **–** | **(280)** |
| Decommissioning provision | **(2,157)** | **(91)** | **–** | **–** | **–** | **(2,248)** |
| Other | **(88)** | **176** | **–** | **–** | **–** | **88** |
| **Deferred tax liabilities, net** | **5,219** | **703** | **(112)** | **(5,766)** | **381** | **425** |

| | Balance January 1 2016 | Recognized in Net Earnings | Recognized in Other Comprehensive Income/Other | Recognized in Discontinued Operations | Change in Foreign Exchange | Balance December 31 2016 |
|---|---|---|---|---|---|---|
| Property and equipment | 24,472 | 7,565 | – | (613) | (28) | 31,396 |
| Other assets | 6,165 | 3,650 | – | (1,163) | (381) | 8,271 |
| Deferred financing costs | 1,525 | 315 | – | – | – | 1,840 |
| Accounts receivable reserves | – | 520 | – | – | – | 520 |
| Financial assets at fair value | – | 264 | – | – | – | 264 |
| Self-insurance reserves | (203) | (53) | – | – | – | (256) |
| Indemnification provisions | (11,158) | – | 280 | 577 | 344 | (9,957) |
| Intangible assets | 885 | (8,693) | – | – | – | (7,808) |
| Employee benefit accruals | (10,477) | (665) | 834 | (91) | (6) | (10,405) |
| Operating loss carryforwards | (1,401) | (1,837) | – | 1,220 | 54 | (1,964) |
| Deferred revenue | (5,262) | 825 | – | – | – | (4,437) |
| Accounts receivable reserves | (165) | – | – | 158 | 7 | – |
| Decommissioning provision | (1,971) | (186) | – | – | – | (2,157) |
| Other | 764 | (95) | 10 | (736) | (31) | (88) |
| **Deferred tax liabilities, net** | 3,174 | 1,610 | 1,124 | (648) | (41) | 5,219 |

## 24. Commitments and Contingencies

### Operating Lease Commitments

At December 31, 2017, the Company was committed under non-cancellable leases requiring future minimum rentals in its continuing operations as follows:

| | Operating Leases |
|---|---|
| 2018 | 3,274 |
| 2019 | 2,866 |
| 2020 | 1,183 |
| 2021 | 910 |
| 2022 | 501 |
| 2023 and beyond | 131 |
| **Total minimum payments** | 8,865 |

### Property and Equipment Commitments

Extendicare has outstanding commitments of $56.0 million at December 31, 2017, in connection with private-pay retirement communities under development in Ontario, which will be substantially financed with external financing. These are expected to be incurred over the next two years.

### Legal Proceedings, Claims and Regulatory Actions

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

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

## 25. Employee Benefits

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

### Defined Benefit Plans

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

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

| | Funded Defined Benefit Plan | | Unfunded Supplementary Defined Benefit Plan | | Total | |
|---|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 |
| Fair value of plan assets | **5,443** | 5,416 | **–** | – | **5,443** | 5,416 |
| Present value of obligations | **7,913** | 7,716 | **34,168** | 34,714 | **42,081** | 42,430 |
| **Deficit** | **(2,470)** | (2,300) | **(34,168)** | (34,714) | **(36,638)** | (37,014) |

#### Funding

As required by law, the registered defined benefit pension plan benefits are funded through a trust, and the Company is responsible for meeting the statutory obligations for funding this plan. The funding requirement for past service is determined based on separate actuarial valuations for funding purposes, which are completed every three years. The most recent actuarial review was performed effective October 1, 2015, and was completed in early 2016.

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

#### Defined Benefit Obligations

| | **2017** | 2016 |
|---|---|---|
| **Present Value of Defined Benefit Obligations** | | |
| Accrued benefit obligations | | |
| Balance at beginning of year | **42,430** | 46,277 |
| Current service cost | **225** | 206 |
| Benefits paid | **(2,603)** | (2,719) |
| Interest costs | **1,447** | 1,689 |
| Actuarial losses (gains) | **582** | (3,023) |
| Balance at end of year | **42,081** | 42,430 |
| Plan assets | | |
| Fair value at beginning of year | **5,416** | 5,406 |
| Employer contributions | **83** | 124 |
| Expected loss (return) on assets | **160** | 124 |
| Actual return on plan assets | **184** | 197 |
| Benefits paid | **(400)** | (435) |
| Fair value at end of year | **5,443** | 5,416 |
| Defined benefit obligations | **36,638** | 37,014 |

The expected contribution to the supplementary plan for the coming year is approximately $2.2 million.

| | **2017** | 2016 |
|---|---|---|
| **Reported in Extendicare's Statements of Financial Position** | | |
| Current accrued liabilities | **2,566** | 2,230 |
| Other long-term liabilities *(note 13)* | **34,072** | 34,784 |
| Accrued benefit liability at end of year | **36,638** | 37,014 |

### Effect of Changes to Defined Benefit Obligations

| | 2017 | 2016 |
|---|---|---|
| **Expense Recognized in Net Earnings (Loss)** | | |
| Annual benefit plan expense | | |
| Current service costs | **225** | 206 |
| Interest cost | **1,263** | 1,492 |
| Plan benefit expense recognized in the year – included in operating expenses and administrative costs | **1,488** | 1,698 |
| **Actuarial Losses Recognized in Other Comprehensive Income** | | |
| Amount accumulated in accumulated deficit at January 1 | **(9,552)** | (11,865) |
| Actuarial loss arising from changes in: | | |
| Discount rate | **–** | – |
| Mortality assumption | **–** | – |
| Other experience | **(583)** | 3,023 |
| Return on assets | **160** | 124 |
| Income tax recovery (expense) on actuarial losses | **112** | (834) |
| Amount recognized in accumulated deficit at December 31 | **(9,863)** | (9,552) |

### Plan Assets

| | 2017 | 2016 |
|---|---|---|
| Equities | **45%** | 47% |
| Fixed income securities | **37%** | 34% |
| Real estate / commercial mortgage | **18%** | 19% |
| | **100%** | 100% |

### Actuarial Assumptions

| | 2017 | 2016 |
|---|---|---|
| Discount rate for year-end accrued obligation | **3.25%** | 3.50% |
| Discount rate for period expense | **3.50%** | 3.75% |
| Rate of compensation increase | **2.0%** | 2.0% |
| Income Tax Act limit increase | **3.0%** | 3.0% |
| Average remaining service years of active employees | **2** | 2 |

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

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

Changes to the following actuarial assumptions, while holding the other assumptions constant, would have affected the defined benefit obligation and related expense for 2017 by the amounts shown below.

| | Increase (Decrease) in Benefit Obligation | Increase (Decrease) in Net Earnings |
|---|---|---|
| Discount rate: | | |
| 1% increase | (4,061) | (168) |
| 1% decrease | 4,837 | 231 |
| Rate of compensation increase | | |
| 1% increase | 7 | (1) |
| 1% decrease | (7) | 1 |
| Income Tax Act limit increase | | |
| 1% increase | – | – |
| 1% decrease | – | – |
| Mortality rate | | |
| 10% increase | (960) | 33 |
| 10% decrease | 1,055 | (35) |

## Defined Contribution Plans

Canada maintains registered savings and defined contribution plans and matches up to 120% of the employees' contributions according to seniority, subject to a maximum based on the salary of the plan participants. Contributions expensed by Canada in 2017 and 2016 were $16.5 million and $15.4 million, respectively.

# 26. Management of Risks and Financial Instruments

## a) Management of Risks

### Management of Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting its contractual obligations. We manage our liquidity risk through the use of budgets and forecasts. Cash requirements are monitored regularly based on actual financial results and actual cash flows to ensure that there are sufficient resources to meet operational requirements. We ensure that there are sufficient funds for declared and payable distributions and any other future commitments at any point in time. In addition, since there is a risk that 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 *(note 12)*.

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

| **As at December 31, 2017** | Carrying Amount | Contractual Cash Flows | Less than 1 Year | 1–2 Years | 2–5 Years | More than 5 Years |
|---|---|---|---|---|---|---|
| Convertible debentures | **124,800** | **141,680** | 7,590 | 134,090 | – | – |
| CMHC mortgages | **123,911** | **155,149** | 22,656 | 13,139 | 76,277 | 43,077 |
| Non-CMHC mortgages | **172,844** | **234,286** | 12,342 | 12,340 | 77,498 | 132,106 |
| Construction loans | **29,868** | **30,735** | 30,735 | – | – | – |
| Finance lease obligations | **90,323** | **121,309** | 14,553 | 13,719 | 39,544 | 53,493 |
| Accounts payable and accrued liabilities | **126,920** | **126,920** | 126,920 | – | – | – |
| Operating lease obligations | **–** | **8,865** | 3,274 | 2,866 | 2,594 | 131 |
| | **668,666** | **818,944** | 218,070 | 176,154 | 195,913 | 228,807 |

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

### Management of Credit Risk

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

| | Carrying Amount | |
|---|---|---|
| | **2017** | 2016 |
| Cash and short-term investments | **128,156** | 101,582 |
| Restricted cash | **2,300** | 2,227 |
| Accounts receivables, net of allowance *(note 7)* | **42,491** | 52,234 |
| Investments held for self-insured liabilities *(notes 10 and 22)* | **86,296** | 136,109 |
| Amounts receivable and other assets *(note 10)* | **58,541** | 63,470 |
| Deferred consideration *(note 10)* | **–** | 37,429 |
| | **317,784** | 393,051 |

#### *Cash and Short-term Investments*

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

#### *Restricted Cash*

The restricted cash is cash held mainly on account of lender capital reserves with no credit risk.

#### *Accounts Receivables, Net of Allowance*

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

Receivables from government agencies represent the only concentrated group of accounts receivable for Extendicare. In Canada, Extendicare has receivables primarily from provincial government agencies. Management does not believe there is any credit risk associated with these government agencies other than possible funding delays. Accounts receivable other than from government agencies consist of private individuals that are subject to different economic conditions, none of which represents any concentrated credit risk to the Company.

The maximum exposure to credit risk for accounts receivable at the reporting date is the carrying value of each class of receivable, denominated in the following currencies.

| | **2017** | | | 2016 | | |
|---|---|---|---|---|---|---|
| | **Carrying Amount** | | | Carrying Amount | | |
| | **U.S. Dollar** | **Canadian Dollar** | **Total** | U.S. Dollar | Canadian Dollar | Total |
| Trade receivables | **–** | **33,466** | **33,466** | – | 40,832 | 40,832 |
| Retroactive rate receivables | **–** | **–** | **–** | – | 585 | 585 |
| Other receivables | **1,544** | **7,481** | **9,025** | 3,352 | 7,465 | 10,817 |
| | **1,544** | **40,947** | **42,491** | 3,352 | 48,882 | 52,234 |

Receivables from Canadian government agencies, which are included in accounts receivable, notes, mortgages and amounts receivable, represented the only concentrated group of credit risks for the Company. As at December 31, 2017, receivables from government agencies represented approximately 91% of the total receivables (2016 – 83%). Management does not believe that there is significant credit risk associated with these government agencies other than possible funding delays. Management continuously monitors reports from trade associations or notes from provincial or federal agencies that announce possible delays that are rare to occur and usually associated with changes of fiscal intermediaries or changes in information technology or forms.

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

As at December 31, 2017, the Canadian operations had trade receivables of $33.5 million (2016 – $40.8 million). All the receivables were fully performing and collectible in the amounts outlined above. The Canadian operations continuously monitor the collection of all trade receivables and assess the collectability and aging of accounts by payor type and on an individual basis.

The aging analysis of these trade receivables is as follows:

| | **2017** | 2016 |
|---|---|---|
| Current | **22,800** | 31,895 |
| Between 30 and 90 days | **6,846** | 6,985 |
| Between 90 and 365 days | **1,779** | 3,058 |
| Over 365 days | **3,638** | 712 |
| Less: provision for receivable impairment | **(1,597)** | (1,818) |
| | **33,466** | 40,832 |

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

| | **2017** | 2016 |
|---|---|---|
| At January 1 | **1,818** | 2,133 |
| Increase in provision for receivable impairment | **1,710** | 1,823 |
| Receivables written off as uncollectible | **(1,931)** | (2,118) |
| Other | **–** | (20) |
| **At December 31** | **1,597** | 1,818 |

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

***Investments Held for Self-insured Liabilities***

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

***Notes, Mortgages and Amounts Receivable***

Included in notes, mortgages and amounts receivable were $58.5 million (2016 – $63.5 million) of discounted amounts receivable due from government agencies. These represent non-current amounts funded by the Ontario government for a portion of nursing centre construction costs over a 20-year or 25-year period *(note 10)*. The Company does not believe there is any credit exposure for these amounts due from government agencies.

### Management of Currency Risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. 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 December 31, 2017 *(note 22)*.

| *(in thousands of US$)* | **2017** |
|---|---|
| Assets | |
| Current assets | **30,895** |
| Investments held for self-insured liabilities | **68,647** |
| Liabilities | |
| Current liabilities | **19,305** |
| Indemnification provisions | **18,040** |
| Other long-term liabilities | **30,074** |
| Net asset exposure | **32,123** |

***Net Earnings Sensitivity Analysis***

Prior to the U.S. Sale Transaction, the majority of the Company's operations were conducted in the United States. As at December 31, 2017, U.S. operations accounted for less than 1% of its revenue from continuing operations (2016 – less than 1%).

Every one cent strengthening of the Canadian dollar against the U.S. dollar in 2017 would favourably impact net earnings by $0.1 million and OCI by $0.2 million. This analysis assumes that all other variables, in particular the interest rates, remain constant.

### Management of Interest Rate Risk

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

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 December 31, 2017, construction loans of $29.9 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 12)*.

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 10)*:

| | Carrying Amount | |
|---|---|---|
| | **2017** | 2016 |
| Fixed-rate instruments: | | |
| Long-term debt[(1)] | **512,218** | 497,705 |
| **Total liability in fixed-rate instruments** | **512,218** | 497,705 |
| Variable-rate instruments: | | |
| Long-term debt[(1)] | **29,868** | 12,605 |
| **Total liability in variable-rate instruments** | **29,868** | 12,605 |

(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 December 31, 2017, long-term debt with variable rates represented 5.5% 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 10 and 20)*.

***Cash Flow Sensitivity Analysis for Variable-rate Instruments***

An increase of 100 basis points in interest rates would have decreased net earnings by $0.2 million and a decrease of 100 basis points in interest rates would have increased net earnings by $0.2 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.

## b) Fair Values of Financial Instruments

| 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** |

| As at December 31, 2016 | 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 | 101,582 | – | – | – | 101,582 | 101,595 |
| Restricted cash | 2,227 | – | – | – | 2,227 | 2,227 |
| Invested assets[1] | 442 | – | – | – | 442 | 442 |
| Accounts receivable | 52,234 | – | – | – | 52,234 | 52,234 |
| Interest rate swaps | – | – | 985 | – | 985 | 985 |
| Amounts receivable and other assets[2] [3] | 63,470 | – | – | – | 63,470 | 66,970 |
| Deferred consideration[3] | 37,429 | – | – | – | 37,429 | 37,430 |
| Investments held for self-insured liabilities | – | 136,109 | – | – | 136,109 | 136,109 |
| | 257,384 | 136,109 | 985 | – | 394,478 | 397,992 |
| Financial liabilities: | | | | | | |
| Accounts payable | – | – | – | 6,738 | 6,738 | 6,738 |
| Long-term debt excluding convertible debentures[3] [4] | – | – | – | 386,398 | 386,398 | 413,582 |
| Convertible debentures | – | – | – | 123,912 | 123,912 | 135,342 |
| | – | – | – | 517,048 | 517,048 | 555,662 |

(1) Included in other assets.
(2) Primarily includes amounts receivable from government.
(3) Includes current portion.
(4) Excludes netting of financing costs.

### Basis for Determining Fair Values

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

Fair values for investments designated as available for sale are based on quoted market prices.

Items designated as loans and receivables include cash, accounts receivable as well as notes, mortgages and amounts receivable. Accounts receivable, including other long-term receivables, are recorded at amortized cost. The carrying values of accounts receivable approximate fair values due to their short-term maturities, with the exception of certain settlement receivables from third-party payors that are anticipated to be collected beyond one year. The fair values of these settlement receivables are estimated based on discounted cash flows at current borrowing rates. Notes, mortgages and amounts receivable primarily consist of notes and amounts receivable from government agencies, and other third-party notes. The fair values for these instruments are based on the amount of future cash flows associated with each instrument, discounted using current applicable rates for similar instruments of comparable maturity and credit quality. The fair values of convertible debentures are based on the closing price of the publicly traded convertible debentures on each reporting date, and the fair values of mortgages and other debt are estimated based on discounted future cash flows using discount rates that reflect current market conditions for instruments with similar terms and risks.

### Fair Value Hierarchy

We use a fair value hierarchy to categorize the type of valuation techniques from which fair values are derived: 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 were as follows:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **As at December 31, 2017:** | | | | |
| Investments held for self-insured liabilities | **86,296** | **–** | **–** | **86,296** |
| Amounts receivable and other assets | **–** | **62,950** | **–** | **62,950** |
| Interest rate swaps | **–** | **3,459** | **–** | **3,459** |
| Convertible debentures | **129,650** | **–** | **–** | **129,650** |
| **As at December 31, 2016:** | | | | |
| Investments held for self-insured liabilities | 136,109 | – | – | 136,109 |
| Amounts receivable and other assets | – | 67,620 | – | 67,620 |
| Deferred consideration *(note 10)* | – | – | 37,430 | 37,430 |
| Interest rate swaps | – | 985 | – | 985 |
| Convertible debentures | 135,342 | – | – | 135,342 |

## 27. Capital Management

The completion of the U.S. Sale Transaction facilitated the repositioning of Extendicare as a pure-play Canadian senior care and services company. The Company's objective is to further expand and grow our Canadian operations including growing our long-term care revenue through redevelopment, and exploring opportunities in the private-pay retirement space.

The Company accesses the capital markets periodically to fund acquisitions, growth capital expenditures and certain other expenditures. We monitor the capital markets to assess the conditions for raising capital and the cost of such capital relative to the return on any acquisitions or growth capital projects. Funds raised in the capital markets that are not deployed in acquisitions or growth projects are held in high-quality investments with surplus cash held in secure institutions. We manage our cash position and prepare monthly cash flow projections over the remaining and future fiscal periods, and we continuously monitor the level, nature and maturity dates of debt and level of leverage and interest coverage ratios to ensure our compliance with debt covenants. We provide information to the Board on a regular basis in order to carefully evaluate any significant cash flow decisions.

### Normal Course Issuer Bid

On January 10, 2018, Extendicare received the approval of the TSX for the Bid *(note 15)*. As at February 28, 2018, the Company has acquired and cancelled 352,233 Common Shares under the Bid at an average price of $8.94 per share, for a total cost of $3.1 million, all of which were acquired in January 2018.

### Capital Structure

The Company defines its capital structure to include long-term debt, net of cash and short-term investments, and share capital.

| | **2017** | 2016 |
|---|---|---|
| Current portion of long-term debt [1] | **59,664** | 54,826 |
| Long-term debt [1] | **476,404** | 448,742 |
| Total debt | **536,068** | 503,568 |
| Less: cash and short-term investments | **(128,156)** | (101,582) |
| Net debt | **407,912** | 401,986 |
| Share capital | **490,881** | 489,656 |
| | **898,793** | 891,642 |

(1) Net of financing costs.

### Dividends

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

### Financial Covenants

Extendicare is subject to external requirements for certain of its loans on debt service coverage. Management and the Board monitor these covenant ratios on a monthly and quarterly basis, respectively. The Company was in compliance with all these covenants as at December 31, 2017.

## 28. Related Party Transactions

### a) 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.

### b) Compensation of Key Management Personnel

The remuneration of directors and other key management personnel of the Company during the years ended December 31, 2017 and 2016, was as follows:

| | **2017** | 2016 |
|---|---|---|
| Short-term benefits | **4,555** | 3,302 |
| Post-employment benefits | **137** | 134 |
| Share-based compensation | **1,773** | 1,331 |
| | **6,465** | 4,767 |

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

## 29. 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.

| | | | | | | | | **2017** |
|---|---|---|---|---|---|---|---|---|
| *(in thousands of Canadian dollars)* | Long-term Care | Retirement Living | Home Health Care | Other Canadian Operations | Corporate Canada | Total Canada | Total U.S. | Total |
| **CONTINUING OPERATIONS** | | | | | | | | |
| **Revenue** | | | | | | | | |
| Long-term care | **616,887** | **–** | **–** | **–** | **–** | **616,887** | **–** | **616,887** |
| Retirement living | **–** | **20,673** | **–** | **–** | **–** | **20,673** | **–** | **20,673** |
| Home health care | **–** | **–** | **435,718** | **–** | **–** | **435,718** | **–** | **435,718** |
| Management, consulting and other | **–** | **–** | **–** | **18,789** | **15** | **18,804** | **5,249** | **24,053** |
| **Total revenue** | **616,887** | **20,673** | **435,718** | **18,789** | **15** | **1,092,082** | **5,249** | **1,097,331** |
| Operating expenses | **542,965** | **18,290** | **391,867** | **8,387** | **–** | **961,509** | **–** | **961,509** |
| Administrative costs | **–** | **–** | **–** | **–** | **30,333** | **30,333** | **1,134** | **31,467** |
| Lease costs | **–** | **–** | **4,778** | **–** | **1,980** | **6,758** | **–** | **6,758** |
| **Total expenses** | **542,965** | **18,290** | **396,645** | **8,387** | **32,313** | **998,600** | **1,134** | **999,734** |
| **Earnings (loss) before depreciation, amortization, and other expense** | **73,922** | **2,383** | **39,073** | **10,402** | **(32,298)** | **93,482** | **4,115** | **97,597** |
| Depreciation and amortization | **–** | **–** | **–** | **–** | **31,379** | **31,379** | **–** | **31,379** |
| **Earnings (loss) before net finance costs and income taxes** | **73,922** | **2,383** | **39,073** | **10,402** | **(63,677)** | **62,103** | **4,115** | **66,218** |
| Interest expense | **–** | **–** | **–** | **–** | **28,082** | **28,082** | **–** | **28,082** |
| Accretion of decommissioning provisions | **–** | **–** | **–** | **–** | **349** | **349** | **–** | **349** |
| Other accretion | **–** | **–** | **–** | **–** | **1,180** | **1,180** | **1,283** | **2,463** |
| Loss (gains) on foreign exchange | **–** | **–** | **–** | **–** | **666** | **666** | **(1,530)** | **(864)** |
| Interest revenue | **–** | **–** | **–** | **–** | **(3,695)** | **(3,695)** | **(207)** | **(3,902)** |
| Fair value adjustments | **–** | **–** | **–** | **–** | **(2,474)** | **(2,474)** | **–** | **(2,474)** |
| Net finance costs (income) | **–** | **–** | **–** | **–** | **24,108** | **24,108** | **(454)** | **23,654** |
| **Earnings (loss) before income taxes** | **73,922** | **2,383** | **39,073** | **10,402** | **(87,785)** | **37,995** | **4,569** | **42,564** |
| **Income tax expense** | | | | | | | | |
| Current | **–** | **–** | **–** | **–** | **10,149** | **10,149** | **–** | **10,149** |
| Deferred | **–** | **–** | **–** | **–** | **603** | **603** | **100** | **703** |
| Total income tax expense | **–** | **–** | **–** | **–** | **10,752** | **10,752** | **100** | **10,852** |
| **Earnings (loss) from continuing operations** | **73,922** | **2,383** | **39,073** | **10,402** | **(98,537)** | **27,243** | **4,469** | **31,712** |
| **DISCONTINUED OPERATIONS** | | | | | | | | |
| Loss from discontinued operations, net of income taxes | **–** | **–** | **–** | **–** | **–** | **–** | **(29,580)** | **(29,580)** |
| **Net earnings (loss)** | **73,922** | **2,383** | **39,073** | **10,402** | **(98,537)** | **27,243** | **(25,111)** | **2,132** |

| (in thousands of Canadian dollars) | Long-term Care | Retirement Living | Home Health Care | Other Canadian Operations | Corporate Canada | Total Canada | Total U.S. | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | 2016 |
| **CONTINUING OPERATIONS** | | | | | | | | |
| **Revenue** | | | | | | | | |
| Long-term care | 608,618 | – | – | – | – | 608,618 | – | 608,618 |
| Retirement living | – | 15,474 | – | – | – | 15,474 | – | 15,474 |
| Home health care | – | – | 414,406 | – | – | 414,406 | – | 414,406 |
| Management, consulting and other | – | – | – | 18,518 | 47 | 18,565 | 3,695 | 22,260 |
| **Total revenue** | 608,618 | 15,474 | 414,406 | 18,518 | 47 | 1,057,063 | 3,695 | 1,060,758 |
| Operating expenses | 532,999 | 14,827 | 374,191 | 8,605 | – | 930,622 | – | 930,622 |
| Administrative costs | – | – | – | – | 28,662 | 28,662 | 1,889 | 30,551 |
| Lease costs | – | – | 4,892 | – | 1,758 | 6,650 | – | 6,650 |
| **Total expenses** | 532,999 | 14,827 | 379,083 | 8,605 | 30,420 | 965,934 | 1,889 | 967,823 |
| **Earnings (loss) before depreciation, amortization, and other expense** | 75,619 | 647 | 35,323 | 9,913 | (30,373) | 91,129 | 1,806 | 92,935 |
| Depreciation and amortization | – | – | – | – | 31,179 | 31,179 | – | 31,179 |
| Other expense | – | – | – | – | 4,013 | 4,013 | – | 4,013 |
| **Earnings (loss) before net finance costs and income taxes** | 75,619 | 647 | 35,323 | 9,913 | (65,565) | 55,937 | 1,806 | 57,743 |
| Interest expense | – | – | – | – | 27,039 | 27,039 | – | 27,039 |
| Accretion of decommissioning provisions | – | – | – | – | 349 | 349 | – | 349 |
| Other accretion | – | – | – | – | 827 | 827 | 1,325 | 2,152 |
| Loss on foreign exchange | – | – | – | – | 753 | 753 | 445 | 1,198 |
| Interest revenue | – | – | – | – | (3,276) | (3,276) | (7,562) | (10,838) |
| Fair value adjustments | – | – | – | – | (985) | (985) | – | (985) |
| Net finance costs (income) | – | – | – | – | 24,707 | 24,707 | (5,792) | 18,915 |
| **Earnings (loss) before income taxes** | 75,619 | 647 | 35,323 | 9,913 | (90,272) | 31,230 | 7,598 | 38,828 |
| **Income tax expense (recovery)** | | | | | | | | |
| Current | – | – | – | – | 6,818 | 6,818 | (1,017) | 5,801 |
| Deferred | – | – | – | – | (2,094) | (2,094) | 3,704 | 1,610 |
| Total income tax expense | – | – | – | – | 4,724 | 4,724 | 2,687 | 7,411 |
| **Earnings (loss) from continuing operations** | 75,619 | 647 | 35,323 | 9,913 | (94,996) | 26,506 | 4,911 | 31,417 |
| **DISCONTINUED OPERATIONS** | | | | | | | | |
| Loss on sale of U.S. operations, net of income taxes | – | – | – | – | – | – | (8,458) | (8,458) |
| Earnings from discontinued operations, net of income taxes | – | – | – | – | – | – | 12,493 | 12,493 |
| **Net earnings (loss)** | 75,619 | 647 | 35,323 | 9,913 | (94,996) | 26,506 | 8,946 | 35,452 |

## 30. Significant Subsidiaries

The following is a list of the significant subsidiaries as at December 31, 2017, all of which are 100% directly or indirectly owned by the Company.

| | Jurisdiction of Incorporation |
|---|---|
| Extendicare (Canada) Inc. | Canada |
| ParaMed Inc. | Canada |
| Harvest Retirement Community Inc. | Canada |
| Stonebridge Crossing Retirement Community Inc. | Canada |
| Empire Crossing Retirement Community Inc. | Canada |
| Yorkton Crossing Retirement Community Inc. | Canada |
| West Park Crossing Retirement Community Inc. | Canada |
| 9623094 Canada Inc. | Canada |
| Laurier Indemnity Company, Ltd. | Bermuda |

## 31. Subsequent Event

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

# Three-year Summary

| *(unaudited) (thousands of dollars unless otherwise noted)* | **2017** | 2016 | 2015 |
|---|---|---|---|
| **Financial Position** | | | |
| Property and equipment | **479,968** | 465,433 | 426,191 |
| Total assets | **934,281** | 988,617 | 1,026,947 |
| Long-term debt, including current portion | **536,068** | 503,568 | 454,074 |
| Shareholders' equity | **128,956** | 174,759 | 172,129 |
| Number of shares outstanding *(year end)* | **88,523,290** | 88,684,485 | 87,953,291 |
| **Financial Results** | | | |
| Revenue from continuing operations | | | |
| Long-term care | **616,887** | 608,618 | 594,198 |
| Retirement living | **20,673** | 15,474 | 1,238 |
| Home health care | **435,718** | 414,406 | 326,964 |
| Management, consulting and other | **18,804** | 18,565 | 15,583 |
| U.S. remaining operations | **5,249** | 3,695 | 5,296 |
| | **1,097,331** | 1,060,758 | 943,279 |
| Net operating income from continuing operations [1] | | | |
| Long-term care | **73,922** | 75,619 | 69,490 |
| Retirement living | **2,383** | 647 | 251 |
| Home health care | **43,851** | 40,215 | 36,521 |
| Management, consulting and other | **10,417** | 9,960 | 8,232 |
| U.S. remaining operations | **5,249** | 3,695 | 5,296 |
| | **135,822** | 130,136 | 119,790 |
| Adjusted EBITDA [1] | **97,597** | 92,935 | 83,691 |
| Earnings from continuing operations before separately reported items [1] | **29,192** | 30,907 | 24,517 |
| Gain (loss) on sale of U.S. operations | **–** | (8,458) | 205,418 |
| Net earnings | **2,132** | 35,452 | 232,078 |
| AFFO (Canadian continuing operations) [1] | **58,351** | 58,625 | 43,990 |
| per basic share *($)* | **0.66** | 0.66 | 0.50 |
| AFFO [1] | **58,495** | 65,056 | 50,828 |
| per basic share *($)* | **0.66** | 0.74 | 0.58 |
| Dividends declared per share *($)* | **0.48** | 0.48 | 0.48 |
| Dividend payout ratio *(% of AFFO)* | **73** | 65 | 83 |
| Average U.S./Canadian dollar exchange rate | **1.2986** | 1.3248 | 1.2787 |
| **Other Information** | | | |
| Number of senior care centres operated *(year end)* | | | |
| Owned/leased [2] | | | |
| Long-term care | **58** | 58 | 58 |
| Retirement living | **8** | 7 | 4 |
| Managed | **50** | 53 | 54 |
| | **116** | 118 | 116 |
| Operational resident capacity of senior care centres *(year end)* | | | |
| Owned/leased [2] | | | |
| Long-term care | **8,112** | 8,116 | 8,116 |
| Retirement living | **676** | 574 | 348 |
| Managed | **6,216** | 6,332 | 6,426 |
| | **15,004** | 15,022 | 14,890 |
| Average occupancy of long-term care centres (owned/leased) *(%)* | **97.7** | 98.0 | 97.9 |
| Average occupancy of retirement living communities *(%)* | **69.7** | 59.8 | 64.1 |
| As at occupancy of retirement living communities *(%)* | | | |
| Stabilized communities | **95.9** | 93.9 | 74.2 |
| Lease-up communities | **68.6** | 41.5 | 61.0 |
| Home health care hours of service | **11,327,000** | 10,909,000 | 8,873,000 |
| Number of employees *(year end)* | **23,700** | 23,800 | 23,000 |
| Senior care and living operations | **12,000** | 12,000 | 11,700 |
| Home health care operations | **11,700** | 11,800 | 11,300 |

(1) Refer to discussion of non-GAAP measures on page 18.

(2) Extendicare operates nine long-term care centres under finance lease arrangements, whereby ownership transfers to Extendicare at the end of the respective lease terms.

# Securityholder Information

## Extendicare Inc.

3000 Steeles Ave. East, Suite 103
Markham, Ontario Canada L3R 4T9
Tel: (905) 470-4000
Fax: (905) 470-5588

www.extendicare.com

## Transfer Agent

**Computershare Trust Company of Canada**
Tel: (800) 564-6253
Fax: (866) 249-7775

Email: service@computershare.com
www.computershare.com

## Exchange Listings/ Trading Profile

**Toronto Stock Exchange Symbols**
Common shares: EXE
Convertible debentures: EXE.DB.B

**2017 EXE Common Share Activity**
High: $10.75; Low: $8.73
Close: $9.15; Volume: 41,984,011

## Shareholder Inquiries/ Investor Relations

**Jillian Fountain**
Corporate Secretary
Tel: (905) 470-5534
Fax: (905) 470-4003

Email: jfountain@extendicare.com

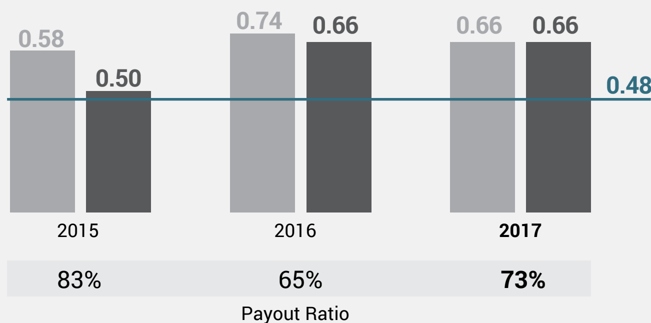
## Annual Meeting

Shareholders are invited to attend the Annual General Meeting of Extendicare Inc. on May 24, 2018, at 10:30 a.m., at the TMX Broadcast Centre - the Gallery, 130 King Street West, Toronto, Ontario, Canada.

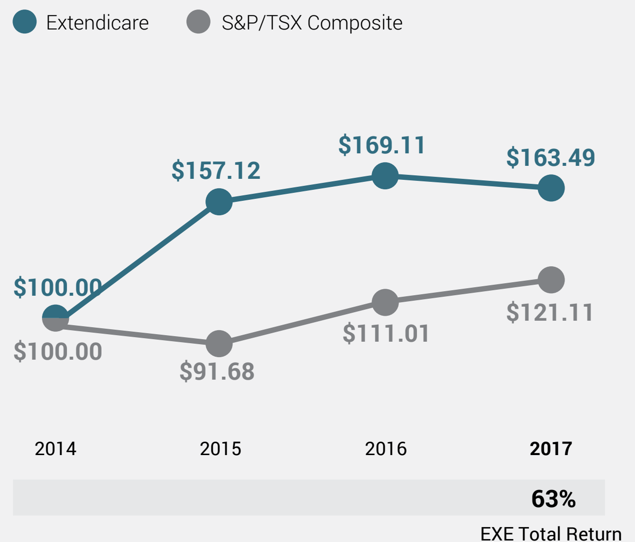
## Published Information

Extendicare's 2017 Annual Report is available for viewing or printing on its website at www.extendicare.com, together with news releases, quarterly reports and other filings with the securities commissions. Printed copies of the annual report are available upon request to the Corporate Secretary.

**Extendicare AFFO and Cash Dividends**




**Total Return Share Price Performance (assuming $100 investment was made on December 31, 2014)**



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