EXTENDICARE

Shareholders' Quarterly Report

Nine Months Ended September 30, 2012

Dated November 7, 2012

Strength

Quality

Stability

...helping people live better

Dear Shareholders,

Extendicare Inc. ("Extendicare" or the "Company") reported results for the three and nine months ended September 30, 2012.

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

Summary of Events in the Quarter and Year to Date include:
(variances exclude effect of foreign exchange)

- Revenue was $498.5 million in Q3 2012, and included a decline of $10.1 million from same-facility operations over Q3 2011.
- Average daily revenue rates for Medicare Part A and Managed Care in Q3 2012 declined by 10.6% and 5.1%, respectively, over Q3 2011, and increased by 2.4% and 0.9%, respectively, over Q2 2012.
- EBITDA includes strengthening of prior years' reserves of $11.0 million in Q3 2012.
- EBITDA, excluding reserve adjustments, was $48.3 million in Q3 2012, $22.1 million lower than Q3 2011, and $0.5 million lower than Q2 2012.
- EBITDA margin, excluding reserve adjustments, was 9.7% in Q3 2012 compared to 13.3% in Q3 2011 and 9.4% in Q2 2012.
- Continuing strong operating performance from Canadian operations, generating EBITDA margin of 11.0% in Q3 2012 compared to 10.7% in Q3 2011 and 9.4% in Q2 2012.
- AFFO from continuing operations, excluding reserve adjustments, was $22.2 million ($0.260 per basic share) in Q3 2012 compared to $34.6 million ($0.414 per basic share) in Q3 2011 and $25.1 million ($0.297 per basic share) in Q2 2012.
- Distributions in the first nine months of 2012 totalled $53.5 million, or $0.63 per share, representing 93% of AFFO for the same period, or 72% excluding the strengthening of prior years' reserves.
- Dividend of $0.07 per share declared for November.
- Two Ontario redevelopment projects (436 beds) are progressing towards completion in the first half of 2013.

In the third quarter, Extendicare experienced a reduction in revenue and EBITDA as a result of persisting weakness in the U.S. economy and the impact of cuts to Medicare funding to skilled nursing operators implemented in the fourth quarter of 2011. In addition, following our third quarter actuarial review, we strengthened our prior years' reserves for self-insured liabilities to conservatively account for the resolution of new and existing liability claims, which had the effect of further impairing our results for the quarter. We continue to take proactive steps to address our exposure to further liability claims to the furthest extent possible. We are confident that our record of quality, as evidenced by our state and federal surveys and our improved five-star performance, and as recognized by our AHCA Quality Awards received by over 60% of our U.S. centers, demonstrates our commitment to our residents. Looking ahead, we anticipate the return of an environment in the United States of greater political stability and funding certainty. In the meantime, we will remain focused on the delivery of quality care to our customers, continue to manage our business efficiently and prudently, and we will continue to deliver AFFO sufficient to cover our dividends.

We are pleased with the continuing strong and predictable performance of our Canadian operations, as well as with the progress of our two redevelopment projects in Ontario that are set to open in 2013. Once fully operational, we anticipate they will generate incremental EBITDA of approximately $2 million.

Convertible Debt Refinancing

As we previously announced, Extendicare issued $126.5 million of aggregate principal amount of 6.00% convertible unsecured debentures due September 30, 2019, convertible at $11.25 per common share. The net proceeds from the offering were approximately $120.7 million, of which $94.0 million was used on October 29, 2012, to redeem all of the Company's outstanding 7.25% convertible unsecured subordinate debentures due June 2013.

U.S. Subsidiary Closes on Lease of Kentucky Centers

As we previously announced, our wholly owned U.S. subsidiary entered into an agreement to lease all 21 of its Kentucky skilled nursing centers (1,762 beds) to an experienced third-party long-term care operator. Nineteen of these centers (1,545 beds) were leased effective July 1, 2012, and the remaining two centers were leased effective October 1, 2012. As a result of this transaction, Extendicare no longer operates skilled nursing centers in Kentucky. The decision to exit the State of Kentucky is consistent with Extendicare's continuing strategy for achieving ongoing performance improvements that involves the divestiture of operations that impede growth or create undue risk exposure. We believe that this was a prudent step for the Company and for our shareholders.

Provision for Self-insured Liabilities

The results of the 2012 third quarter independent actuarial review necessitated the strengthening of our prior years' reserves this quarter by $11.0 million (US$11.0 million), along with an incremental increase in the level of reserves for the current year. The strengthening of our prior years' reserves was primarily attributable to claims in the State of Kentucky and settlement of certain pre-2012 claims in other states. We had anticipated that following our exit from Kentucky, which has accounted for more than 50% of our provision for self-insured liabilities over the past two years, our provision for self-insured liabilities would be reduced by approximately US$12 million per annum. However, an increase in claims in the quarter in other states has resulted in an actuarial projection that requires an additional provision of US$3.5 million in the quarter. We continue to take all steps possible to manage our risk and mitigate our exposure to future claims.

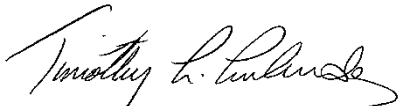
Outlook

Looking forward to the balance of 2012 and beyond, we will continue to look for opportunities to capitalize on our solid base of operations in Canada and grow this portion of our business.

In the U.S., with the presidential election now behind us, we are optimistic that some of the political uncertainty will be eliminated with the return of greater predictability in funding and regulation. In this regard, we are hopeful that the sequestration process may be averted, with the prospect of providing relief from the 2% cut to the Medicare Part A rates slated for January 2013.

As U.S. Congress works towards resolving the fiscal debt crisis, the Company remains at risk of being considered a "pay for" in government cost cutting reduction efforts and we continue to dialogue with policymakers on the potential impact of such reductions on quality and access to care. As part of this process, we are working on proposing alternative solutions to improve the cost effectiveness and efficiency of the U.S. health care system. It is our hope that the U.S. Congress will work cooperatively and productively to foster an economic recovery in the near term.

Thank you for your confidence in our business and your continued support.



Timothy L. Lukenda
President and Chief Executive Officer

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Forward-looking Statements

Information provided by Extendicare from time to time, including this Interim Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to Extendicare and its subsidiaries, including, without limitation, statements regarding its business operations, business strategy, and financial condition. Forward-looking statements can be identified by the expressions "anticipate", "believe", "estimate", "expect", "intend", "objective", "plan", "project" or other similar expressions or the negative thereof. These forward-looking statements reflect the Company's current expectations regarding future results, performance or achievements and are based upon information currently available to the Company and on assumptions that the Company believes are reasonable.

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

The forward-looking statements contained in this Interim 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 Interim Report. Except as required by applicable securities laws, the Company assumes no obligations to update or revise any forward-looking statements.

Additional Information

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

Management's Discussion and Analysis

November 7, 2012

BASIS OF PRESENTATION

Extendicare Inc. ("Extendicare" or the "Company") is the successor to Extendicare Real Estate Investment Trust ("Extendicare REIT" or the "REIT") following the conversion of the REIT from an income trust to a corporate structure pursuant to a plan of arrangement effective July 1, 2012 (the "2012 Conversion"). The 2012 Conversion was accounted for by the Company as a continuity of interest, and accordingly, the consolidated financial statements of the Company are reflective as if the Company had always carried on the business previously carried on indirectly by Extendicare REIT. Commencing with the three and nine months ended September 30, 2012, comparative information for Extendicare relating to periods prior to the 2012 conversion is that of its predecessor, Extendicare REIT. Additional information on the 2012 Conversion can be found under the heading "Overview – Significant 2012 Events and Developments – 2012 Corporate Conversion".

Extendicare has prepared this Management's Discussion and Analysis (MD&A) to provide information to assist its current and prospective investors' with an understanding of the financial results for the three and nine months ended September 30, 2012. This MD&A should be read in conjunction with Extendicare's unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2012, and the notes thereto, together with the MD&A and the audited consolidated financial statements, including the accompanying notes, for the year ended 2011, found in Extendicare REIT's 2011 Annual Report. This material is available on Extendicare's website at www.extendicare.com. Additional information about Extendicare, including its latest Annual Information Form, can be found on SEDAR at www.sedar.com.

Extendicare is a leading North American provider of post-acute and long-term senior care services. Extendicare itself is not a provider of services or products. The operation of the senior care centers and ancillary businesses is conducted by the subsidiaries of Extendicare. This MD&A provides information on Extendicare and its subsidiaries. References to "Extendicare", the "Company" "we", "us" and "our" in this report mean either "Extendicare Inc." alone or together with its subsidiaries, as the context requires. The registered office of Extendicare is located at 3000 Steeles Avenue East, Markham, Ontario, Canada, L3R 9W2.

This MD&A and the accompanying unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2012, including the notes thereto, have been prepared in accordance with International Financial Reporting Standards (IFRS) for interim financial statements. All dollar amounts are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2011, or December 31 of the year referenced.

The discussion and analysis in this MD&A is based upon information available to management as of November 7, 2012. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur, which could affect the Company in the future.

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

OVERVIEW

Business Strategy

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

- ensuring the continued delivery of quality care and customer service throughout our organization;
- focusing on accommodating short-term, high-acuity and rehabilitation residents that result in increasing the percentage of revenue from Medicare and Managed Care (Skilled Mix) funding sources and higher average daily revenue rates;
- actively maintaining and improving our asset portfolio through a disciplined capital reinvestment program or, where appropriate, through disposition of underperforming or non-strategic centers;
- focusing on achieving operational efficiencies and internal growth in our core business and, when available, growth through new developments and value-creating acquisitions;
- expanding non-government based revenue sources and diversifying within the long-term care industry through our rehabilitative services, information technology, management and consulting businesses;
- enhancing our Canadian businesses, including long-term care and home health care operations; and
- increasing funds from operations and adjusted funds from operations.

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

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

Beginning in 2011, Extendicare strengthened its balance sheet by refinancing a significant portion of its long-term debt with government insured mortgages at lower rates and longer terms to maturity. As of November 7, 2012, we had closed on US$506.3 million of mortgages insured by the U.S. Department of Housing and Urban Development Program (HUD) to refinance debt in our U.S. operations, of which US$497.7 million had been completed by the end of the 2012 first quarter. As well in Canada, in December 2011, we refinanced $72.4 million of mortgages that were due in March 2013 and insured by the Canadian Mortgage and Housing Corporation (CMHC) with new CMHC mortgages with maturity dates of 2017 and 2022. Collectively, we estimate the savings in annual debt service costs to Extendicare will be approximately $25 million. Furthermore, we successfully entered into a new US$100.0 million credit facility (the "EHSI Credit Facility") in 2012 upon maturity of our US$70.0 million line of credit. For more information on these debt refinancings, refer to the discussion under the headings "2011/2012 Refinancing Plan" and "EHSI Credit Facility" under the heading "Overview – Significant 2012 Events and Developments".

We believe that Extendicare is a financially stable company with a conservative capital structure. The ownership of our real estate coupled with our geographic diversity position us favourably to address the numerous funding and regulatory challenges facing the industry. While the U.S. funding reductions will have real consequences in the way we operate our business, we are confident that our efforts, combined with our strategic marketing initiatives, will enable us to be successful in this environment.

Investment Overview

An investment in the shares of Extendicare entitles the holder to a monthly cash flow stream, through dividends at the discretion of the board of directors of Extendicare Inc. (the "Board of Directors" or the "Board"), as well as the opportunity, or exposure, to changes in the price of the common shares of Extendicare (the "Common Shares"), which trade on the Toronto Stock Exchange (TSX) under the symbol "EXE". The Board regularly reviews its distribution policy. The present policy of the Board is to pay monthly dividends of $0.07 per share, or $0.84 per share annually, which is unchanged from the former REIT distributions. More information about Extendicare's distributions, including tax considerations, is provided under the heading "Distribution Policy".

Our long-term growth and financial performance is influenced by a number of factors. First and foremost among these factors is the demand for senior care centers and other related long-term care services in the United States and Canada. In both countries, the outlook for these services is favourable due to an aging population as the "baby-boomer" generation enters its senior years. For example, the U.S. Census Bureau estimates that the number of Americans aged 65 and over will increase by 36.2% between 2010 and 2020 compared to a total population growth of 10.0%. Secondly, other important factors affecting results are developments related to government funding in such programs as Medicare and Medicaid in the United States and the envelope funding systems in Ontario. Given that 64.8% of our revenue from continuing operations that was earned in the first nine months of 2012 (2011 year – 66.7%) was generated from our U.S. operations, Medicare and Medicaid funding is particularly significant for our financial performance. In March 2010, the U.S. government passed health care reform legislation and in July 2011, CMS announced the 2011 CMS Final Rule that included Medicare funding reductions and other policy changes that have had a significant impact on the industry. For a discussion of health care reform, recent Medicare and Medicaid funding changes, and other factors affecting the outlook for future funding, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States". Lastly, the long-term care services that we provide are in competition to a degree with other health care providers including assisted living centers, home health agencies, hospice providers and long-term acute care, or LTAC, units within hospitals. Increasingly, state Medicaid programs in the U.S. and provincial programs in Canada are attempting to divert potential admissions to assisted living centers and home care programs. In addition, Medicaid programs are utilizing Managed Care programs to limit the length of stay of our residents in the United States.

Our financial performance is also affected by changes in the U.S./Canadian dollar exchange rate as the results of our U.S. operations are reported in Canadian dollars and Extendicare's distributions are made in Canadian dollars. Consequently, our financial performance benefits when the Canadian dollar weakens relative to the U.S. currency, and conversely our results are negatively impacted when the U.S. dollar weakens relative to the Canadian dollar. Our distributions are funded from both our U.S. and Canadian operations and, therefore, changes in the value of the U.S. dollar could have an impact on our cash available for distribution. We have a foreign currency hedging strategy whereby we monitor and consider entering into foreign currency forward contracts (FCFCs) to reduce the risks associated with changes in the U.S. dollar and the impact such changes could have on our Canadian dollar distributions. Information about the impact of currency translation on our financial results and a review of our foreign currency hedging strategy is provided in the section "Impact of U.S. Dollar and Foreign Currency Translation".

Business Overview

Extendicare, through its wholly owned subsidiary operating entities, is a major provider of short-term and long-term senior care services through its network of owned and operated health care centers in North America, operating 243 senior care centers with capacity for 26,713 residents at September 30, 2012. This excludes two Kentucky skilled nursing centers (217 beds) that have been leased to a third party effective October 1, 2012, as discussed under the heading "Significant 2012 Events and Developments – 2012 Kentucky Lease Transaction".

Extendicare's wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates 158 senior care centers with capacity for 15,472 residents, and has a significant presence (more than 14% of its resident capacity) in each of Pennsylvania, Michigan, Wisconsin, and Ohio. EHSI offers a continuum of health care services, including nursing care, assisted living and related medical specialty services, such as post-acute care and rehabilitative therapy on an inpatient and outpatient basis.

Extendicare's wholly owned Canadian subsidiary, Extendicare (Canada) Inc. and its subsidiaries (collectively "ECI"), operates 85 senior care centers, with capacity for 11,241 residents. ECI has a significant presence in Ontario and Alberta, where approximately 72% and 14% of its residents are served, respectively. Also, through its ParaMed Home Health Care (ParaMed) division, ECI is a major provider of home health care in Ontario and Alberta.

Extendicare owns rather than leases a majority of its properties, unlike a number of other long-term care providers. At September 30, 2012, we operated 201 centers that we either owned or leased with options to purchase, representing approximately 98% of our 206 owned or leased centers, excluding those operated under management contracts and the 21 Kentucky centers that have been leased to third-party operators. We believe that ownership increases our operating flexibility by allowing us to: refurbish centers to meet changing consumer demands; expand or add assisted living and retirement centers adjacent to our nursing centers; adjust licensed capacity to avoid occupancy-based rate penalties; divest centers and exit markets at our discretion; and more directly control occupancy costs.

The following depicts ownership and management of senior care centers operated by EHSI and ECI at September 30, 2012.

	Nursing Centers		Assisted Living and Retirement Centers		Rehab Hospital / Chronic Care Units		Total	
By Type of Ownership	**No. of Centers**	**Resident Capacity**	**No. of Centers**	**Resident Capacity**	**No. of Centers**	**Resident Capacity**	**No. of Centers**	**Resident Capacity**
United States								
Owned	137	14,011	4	305	1	28	142	14,344
Leased [1]	5	519	–	–	–	–	5	519
Managed	4	399	7	210	–	–	11	609
Total	146	14,929	11	515	1	28	158	15,472
Canada								
Owned	48	6,545	1	200	–	–	49	6,745
Leased [1]	10	1,250	–	76	–	–	10	1,326
Managed	22	2,744	3	285	1	141	26	3,170
Total	80	10,539	4	561	1	141	85	11,241
Total	**226**	**25,468**	**15**	**1,076**	**2**	**169**	**243**	**26,713**

(1) Of the centers operated under lease arrangements: 10 centers are under finance lease arrangements, representing nine centers in Canada under 25-year finance lease arrangements maturing beginning in 2026 through to 2028; and one center in the U.S. under a 10-year finance lease arrangement maturing in 2020.

The following reflects the change in operating capacity of our senior care centers during the first nine months of 2012 and the 2011 year.

	Nine months ended September 30, 2012		Year 2011	
Extendicare Senior Care Centers	**No. of Centers**	**Operational Beds/Units**	**No. of Centers**	**Operational Beds/Units**
As at beginning of the year	**261**	**28,107**	266	29,447
Development (owned and leased) [1]	**–**	**–**	3	500
Managed contracts added	**3**	**491**	6	349
Managed contracts matured [2]	**–**	**–**	(11)	(1,765)
Closed [3]	**–**	**–**	(2)	(175)
Divested/leased to third party [4]	**(21)**	**(1,762)**	(1)	(92)
Operational capacity adjustments [5]	**–**	**(123)**	–	(157)
As at the end of the period	**243**	**26,713**	261	28,107

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

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

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

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

(5) The reduction in operational capacity was due primarily to U.S. beds that have been pulled out of service in order to increase our Medicaid rate and to accommodate rehabilitation suites.

Significant 2012 Events and Developments

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

2012 CORPORATE CONVERSION

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

Under the 2012 Conversion, Unitholders had their trust units of the REIT (the "REIT Units") exchanged for Common Shares of Extendicare on the basis of one Common Share for each REIT Unit held. In addition, Extendicare assumed all of the obligations of the REIT in respect of its outstanding 5.70% convertible unsecured subordinated debentures due June 30, 2014, and 7.25% convertible unsecured subordinated debentures due June 30, 2013 (collectively, the "Convertible Debentures"). As a result, holders of the Convertible Debentures are entitled to receive Common Shares on the same basis that REIT Units were previously issuable on the conversion thereof. The Common Shares commenced trading on the TSX on July 5, 2012, under the trading symbol "EXE" and the REIT Units were de-listed concurrently. The Convertible Debentures due June 30, 2014, and June 30, 2013, continued trading on the TSX under the trading symbols "EXE.DB" and "EXE.DB.A", respectively. Further details relating to the 2012 Conversion are contained in the REIT's Management Information and Proxy Circular dated April 2, 2012.

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

Extendicare REIT had been subject to SIFT tax since 2007 at tax rates that were comparable to the general corporate tax rate applicable to Canadian corporations. Consequently, the 2012 Conversion itself did not impact the funds available for distribution by Extendicare to its shareholders. The distribution payout ratio of Extendicare was approximately 93% for the nine months ended September 30, 2012, and was approximately 100% for the 2011 year. The payout ratio has increased since 2010 due to the strengthening of our reserves for self-insured liabilities, along with the negative effect of the 2011 CMS Final Rule that took effect October 1, 2011. In 2009, Extendicare reduced its distributions in order to manage the uncertainty surrounding the economy, U.S. health care reform and our debt refinancing plans. Consequently, during 2009 and 2010, the payout ratios were at conservative levels of approximately 42% and 62%, respectively. The Board regularly monitors Extendicare's cash flow position and projected distribution payout ratio to consider the appropriateness of Extendicare's distributions. In spite of the recent and potential for further U.S. funding reductions and the strengthening of reserves for self-insured liabilities, the Board has made a determination to maintain distributions, in the form of dividends, at the current level of $0.07 per month. The Board will continue to review the distribution policy on a regular basis, taking into consideration factors as they arise.

The declaration and payment of dividends by Extendicare is subject to the discretion of the Board, as to the amount of and if and when a dividend is declared and paid, after consideration of the same factors that were taken into account by the former REIT Board, which factors include results of operations, requirements for capital, future financial prospects and debt covenants, as well as other factors that may be considered to be relevant by the Board.

2012 MEDICARE UPDATE

As previously announced, the net market basket increase for October 2012 was 1.8%, which consisted of a market basket increase of 2.5% minus a productivity adjustment of 0.7%. We estimate that the impact of this 1.8% funding increase will provide us with additional Medicare revenue of approximately US$6.2 million per annum. However, as previously indicated, the Special U.S. Joint Select Committee on Deficit Reduction failed to make a recommendation to reduce government spending by January 15, 2012. This process of sequestration which, if not overturned, will automatically reduce Medicare funding by 2% beginning January 2, 2013. A 2% funding reduction is estimated to reduce our Medicare revenue by approximately US$7 million per annum.

Effective October 2012, CMS established a requirement for pre-approval by a physician of claims over US$3,700 for physical and speech therapy and a second approval process for claims over US$3,700 for occupational therapy. Approval or denial of therapy services beyond these caps is determined on an individual basis and, therefore, the impact cannot be precisely determined. If 100% of the claims over US$3,700 were denied, the loss of revenue to us is estimated to be US$2 million for the fourth quarter of 2012, or US$8 million per annum. It is uncertain whether this interim requirement will extend beyond 2012 as further changes were proposed effective January 1, 2013, as discussed below.

In July 2012, CMS announced, in conjunction with the implementation of Medicare physician fee rates, a 31% reduction of Medicare Part B rates to commence January 1, 2013. The impact of the 31% Part B rate reduction on EHSI's therapy revenue is estimated to be US$11 million per annum. We continue to dialogue with policymakers about the impact of the Part B rate reduction and therapy caps on access to care and quality of life for our residents. The impact of these therapy caps may be mitigated to a certain extent by reductions in staffing and, in some cases, residents paying privately for these services.

2012 KENTUCKY LEASE TRANSACTION

In May 2012, EHSI entered into an agreement to lease all 21 of its skilled nursing centers in the State of Kentucky (1,762 beds) to an experienced third-party long-term care operator based in Texas that operates through its affiliates in a number of other states. Nineteen of these centers (1,545 beds) were leased effective July 1, 2012, and the remaining two centers (217 beds) were leased effective October 1, 2012. Under the agreement, the operating leases have 10-year terms with two 5-year extensions at the option of the operator. In addition, if certain conditions are met, the operator has the option to purchase all of the centers during the initial lease term at agreed upon per bed amounts. As a result of this transaction, EHSI no longer operates skilled nursing centers in Kentucky. The decision to exit the State of Kentucky is consistent with Extendicare's continuing strategy for achieving ongoing performance improvements that involves the divestiture of operations that impede growth or create undue risk exposure. According to the *2012 AON Long Term Care General Liability and Professional Liability Actuarial Analysis* (the "2012 AON Study"), the loss rate in Kentucky has increased from US$690 per bed in 2004 to US$4,930 per bed in 2011, and is projected to be US$5,120 per bed in 2012.

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

For further information, refer to *notes 5 and 11* of the unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2012.

PROVISION FOR SELF-INSURED LIABILITIES

The results of the 2012 third quarter independent actuarial review necessitated the strengthening of our prior years' reserves this quarter by $11.0 million (US$11.0 million), along with an incremental increase in the level of reserves for the current year. The strengthening of our prior years' reserves was primarily attributable to claims in the State of Kentucky and settlement of certain pre-2012 claims in other states. We had anticipated that following our exit from Kentucky, which has accounted for more than 50% of our provision for self-insured liabilities over the past two years, our provision for self-insured liabilities would be reduced by approximately US$12 million per annum. However, an increase in new claims in the quarter in other states has resulted in an actuarial projection that required an additional provision of US$3.5 million in the quarter.

For the nine months ended September 30, 2012, we have made provisions for self-insured liabilities of $34.8 million (US$34.8 million), of which $16.6 million (US$16.6 million) related to the strengthening of our prior years' reserves. In comparison, in the same 2011 period, our provision for self-insured liabilities was $49.2 million (US$50.3 million), of which $31.4 million (US$32.1 million) related to prior years' reserves. For the year ended December 31, 2011, our provision for self-insured liabilities was $65.3 million (US$66.0 million), of which $42.8 million (US$43.3 million) related to prior years' reserves.

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

2011/2012 REFINANCING PLAN

Issue of 2019 Convertible Debentures and Redemption of 2013 Convertible Debentures

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

The net proceeds from the offering were approximately $120.7 million, of which $94.0 million was used on October 29, 2012, to redeem all of Extendicare's outstanding 7.25% convertible unsecured subordinate debentures due June 2013 (the "2013 Debentures"). The redemption price of the 2013 Debentures was equal to the sum of the outstanding aggregate principal amount of $91,794,000 and all accrued and unpaid interest thereon for a total of $93,999,810, or $1,024.03 per $1,000 principal amount of 2013 Debentures.

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

U.S. Operations – HUD Mortgages

EHSI has substantially completed the refinancing of approximately US$636 million of debt with approximately US$510 million in HUD-insured mortgages and US$126 million of cash on hand. As at November 7, 2012, EHSI had closed on 68 HUD loans with a principal balance of US$506.3 million in connection with this refinancing, of which US$503.3 million on 67 HUD loans had closed by the end of September 2012. EHSI anticipates obtaining and closing on the one remaining HUD commitment with a principal balance of US$3.9 million by the end of the 2013 first quarter. Upon conclusion of this refinancing, EHSI anticipates it will have closed on approximately US$510 million in new HUD-insured mortgages with a weighted average rate of approximately 4.26%, inclusive of MIP fees, and term to maturity of about 32 years. The annualized interest savings from the refinancing is estimated to be US$20 million.

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

In July 2010, EHSI received approval as a corporate entity to proceed with HUD applications, subject to an overall limit of US$550.0 million, and in December 2011, received approval to increase the overall limit to US$585.0 million. EHSI already had approximately US$27 million of HUD loans issued prior to this refinancing plan. In addition to the US$510 million resulting from the refinancing plan discussed above, EHSI is in the process of securing further HUD loans to refinance existing debt that would utilize approximately US$574 million of its US$585.0 million overall limit before it expires in October 2013. As at September 30, 2012, EHSI had approximately 55 unencumbered centers valued at an estimated US$250 million, none of which are part of the additional HUD financings yet to be completed.

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

Canadian Operations – CMHC Mortgages

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

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

EHSI CREDIT FACILITY

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

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

As at the end of September 2012, we had drawn US$6.4 million on the EHSI Credit Facility and issued US$2.6 million under a letter of credit, leaving US$91.0 million available. At EHSI's option, the interest rate is either the eurodollar rate, with a floor set at 1%, plus a margin from 4% to 4.50%, or the U.S. prime rate plus a margin from 3% to 3.50%, with the specific margin based on EHSI's consolidated leverage ratio as defined in the EHSI Credit Facility. The interest rate at September 30, 2012 was 5.00% (December 31, 2011 – 6.43% under the former agreement).

For further information on the U.S. and Canadian refinancings, refer to *note 7* of the unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2012.

2011 CMS FINAL RULE

The 2011 CMS Final Rule that was effective October 1, 2011, included an 11.1% reduction in Medicare funding to skilled nursing centers along with the elimination of group therapy and changes in the assessment process. The impact of the 2011 CMS Final Rule was not fully realized in our 2011 fourth quarter results due to the transitional rules in place. Therefore, we experienced a further 1.6% decline in our average Medicare Part A rate in the 2012 first quarter from the 2011 fourth quarter levels. Our average daily revenue rates for Medicare Part A and Managed Care declined by 12.5% and 6.9%, respectively, in the 2012 first quarter from the 2011 third quarter levels. We estimate that the impact of the CMS Final Rule, prior to implementing cost saving measures, is a reduction of our revenue and EBITDA by approximately US$64 million on an annualized basis. We have taken measures to help mitigate the adverse effect of the elimination of group therapy and the assessment process changes, such as employing more therapists and improving productivity.

Prior to October 1, 2011, we completed a thorough review of our operations and implemented a number of changes within our organization and secured vendor pricing concessions. These savings are anticipated to reduce our general, administrative and non-wage operating costs by an estimated US$24 million on an annualized basis. None of these cost saving measures involved a reduction of direct care staffing at our centers. Therefore, we estimate that the net negative effect of the 2011 CMS Final Rule on our EBITDA, partially offset by our cost saving initiatives, is approximately US$40 million on an annualized basis.

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

KEY PERFORMANCE INDICATORS

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

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

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

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

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

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

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

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

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

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

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

"Same facility", in the context of comparing our 2012 and 2011 operations in this document, refers to those centers that were operated by us on January 1, 2011, and throughout 2011 and 2012; and

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

U.S. Operations

We focus on short-term stay programs and offering care to residents with higher acuity and those requiring rehabilitative care and services in our skilled nursing center operations. These residents are primarily admitted into our centers with Medicare and Managed Care as their primary funding source. Approximately 45% of our Managed Care residents have rates that are RUGs-based or partially aligned to the Medicare rates. Medicaid rates are generally lower than rates earned from other sources. Therefore, we consider Skilled Mix to be an important performance measurement indicator. During 2011 approximately 82% of our admissions were Medicare or Managed Care funded, with 53% funded by Medicare and 29% funded by Managed Care.

Our goal in the U.S. skilled nursing center operations is to grow revenue by providing higher acuity and short-term rehabilitative services to our residents and return them to lower-cost settings, while increasing the revenue with Medicare and Managed Care as funding sources. Individuals who do not qualify for a funded program pay for the services directly. Therefore, we focus on these payor types to increase average daily revenue rates and improve Quality Mix census as a percentage of the total ADC. After the short-term rehabilitative portion of a resident's stay, residents who require further longer-term care and who do not have the financial means to pay for their care, seek funding from state Medicaid programs at rates that are generally lower than those earned from other sources.

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

SKILLED NURSING CENTER REVENUE BY PAYOR SOURCE

The financial impact of the October 2010 implementation of MDS 3.0 and RUG-IV, followed by the 2011 CMS Final Rule, significantly impacted the average daily Medicare Part A and Managed Care rates in each of the quarters subsequent to October 1, 2010. Following the October 2010 funding changes that CMS stated were intended to be budget neutral, our average Medicare Part A and Managed Care rates, excluding prior period settlement adjustments, increased during the first nine months of 2011 by 12.7% and 8.3%, respectively, over the same 2010 period. Following the implementation of the 2011 CMS Final Rule, our average Medicare Part A and Managed Care rates declined in the 2011 fourth quarter by 11.0% and 7.0%, respectively, from the 2011 third quarter levels. The decline in our average rates in the 2011 fourth quarter was not as much as anticipated due to the transitional rules provided for in the changeover to the new assessment process. As a result, we experienced a further decline in our average Medicare Part A rates in the 2012 first quarter. In the 2012 first quarter, our average daily Medicare Part A and Managed Care rates were US$456.29 and US$426.07, respectively, and compared to the 2011 third quarter levels immediately prior to the implementation of the 2011 CMS Final Rule, they were lower by 12.5% and 6.9%, respectively. We estimate that the impact of the 2011 CMS Final Rule on our revenue and EBITDA is a reduction of approximately US$64 million on an annualized basis, prior to our cost saving measures. For the 2012 third quarter, our average daily Medicare Part A and Managed Care rates were US$466.23 and US$434.35, respectively, and represented a decrease over the 2011 third quarter levels of 10.6% and 5.1%, respectively. In comparison to the 2012 second quarter levels, our average Medicare Part A and Managed Care rates improved by 2.4% and 0.9%, respectively. For a discussion of recent Medicare funding changes, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

The percentage of Medicare residents receiving therapy services improved to 86.1% in the 2012 third quarter from 85.2% in the 2012 second quarter.

Our average daily Medicaid rate, excluding prior period settlement adjustments, increased this quarter by 3.8% to US$190.42 over US$183.42 in the 2011 third quarter, and by 1.9% from US$186.83 in the 2012 second quarter. However, revenue from the Medicaid rate increases was partially offset by higher state provider taxes, resulting in a net increase of 3.2% this quarter in comparison to the 2011 third quarter. For the majority of the states in which we operate, Medicaid funding changes take effect in July and October. For a discussion of recent Medicaid funding changes, please refer to the section "Update of Regulatory and Reimbursement Changes Affecting Revenue – United States".

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

	Q1		Q2		Q3		Q4		Year
(total operations)	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2010**	**2011**
Revenue by Payor Source *(%)*									
Medicare	**31.9**	36.7	**31.7**	36.2	**30.5**	34.8	32.2	33.9	34.9
Managed Care	**10.2**	10.3	**9.6**	10.1	**10.2**	10.0	9.6	9.7	10.0
Skilled Mix	**42.1**	47.0	**41.3**	46.3	**40.7**	44.8	41.8	43.6	44.9
Private/other	**8.8**	8.1	**9.0**	8.0	**9.4**	8.6	9.1	9.2	8.5
Quality Mix	**50.9**	55.1	**50.3**	54.3	**50.1**	53.4	50.9	52.8	53.4
Medicaid	**49.1**	44.9	**49.7**	45.7	**49.9**	46.6	49.1	47.2	46.6
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	100.0	100.0	100.0
Average Revenue Rate by Payor Source *(US$)*									
Medicare Part A	**456.29**	515.49	**455.25**	515.90	**466.23**	521.24	463.89	508.95	503.75
Medicare Parts A and B	**504.91**	552.58	**502.54**	555.03	**519.37**	569.12	513.24	554.94	546.91
Managed Care	**426.07**	447.77	**430.66**	441.06	**434.35**	457.71	425.80	442.88	442.81
Private/other	**232.15**	221.07	**236.02**	228.04	**237.80**	226.49	224.17	221.51	224.91
Medicaid	**185.00**	180.20	**186.83**	180.99	**190.42**	183.42	184.83	181.58	182.49
Weighted average	**256.19**	266.40	**256.75**	266.27	**260.47**	266.56	255.46	260.08	263.56

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

	Q1		Q2		Q3		Q4	Year
(same-facility operations)	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2011**
Revenue by Payor Source *(%)*								
Medicare	**32.1**	36.9	**32.0**	36.4	**30.6**	34.9	32.5	35.2
Managed Care	**10.9**	11.0	**10.3**	10.9	**10.3**	10.7	10.3	10.7
Skilled Mix	**43.0**	47.9	**42.3**	47.3	**40.9**	45.6	42.8	45.9
Private/other	**8.9**	8.3	**9.1**	8.1	**9.3**	8.7	9.1	8.5
Quality Mix	**51.9**	56.2	**51.4**	55.4	**50.2**	54.3	51.9	54.4
Medicaid	**48.1**	43.8	**48.6**	44.6	**49.8**	45.7	48.1	45.6
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	100.0	100.0

On a same-facility basis, the percentage of our Skilled Mix revenue to total revenue declined to 40.9% in the 2012 third quarter from 45.6% in the 2011 third quarter primarily as a result of the impact of the 2011 CMS Final Rule and due to a decline in Skilled Mix census levels, as discussed in the following section.

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

SKILLED NURSING CENTER AVERAGE DAILY CENSUS

The following table provides the ADC, percentage of total ADC, and average occupancy of EHSI's skilled nursing centers from total operations, for the past eight quarters and the 2011 year.

	Q1		Q2		Q3		Q4		Year
(total operations)	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2010**	**2011**
Average Daily Census									
Medicare	**2,283**	2,524	**2,263**	2,451	**1,918**	2,296	2,250	2,249	2,379
Managed Care	**861**	871	**804**	862	**768**	818	814	810	841
Skilled Mix	**3,144**	3,395	**3,067**	3,313	**2,686**	3,114	3,064	3,059	3,220
Private/other	**1,365**	1,396	**1,366**	1,317	**1,287**	1,434	1,455	1,529	1,401
Quality Mix	**4,509**	4,791	**4,433**	4,630	**3,973**	4,548	4,519	4,588	4,621
Medicaid	**9,568**	9,476	**9,551**	9,477	**8,578**	9,545	9,532	9,583	9,508
Total	**14,077**	14,267	**13,984**	14,107	**12,551**	14,093	14,051	14,171	14,129
Census by Payor Type *(%)*									
Medicare	**16.2**	17.7	**16.2**	17.4	**15.3**	16.3	16.0	15.9	16.8
Managed Care	**6.1**	6.1	**5.7**	6.1	**6.1**	5.8	5.8	5.7	6.0
Skilled Mix	**22.3**	23.8	**21.9**	23.5	**21.4**	22.1	21.8	21.6	22.8
Private/other	**9.7**	9.8	**9.8**	9.3	**10.3**	10.2	10.4	10.8	9.9
Quality Mix	**32.0**	33.6	**31.7**	32.8	**31.7**	32.3	32.2	32.4	32.7
Medicaid	**68.0**	66.4	**68.3**	67.2	**68.3**	67.7	67.8	67.6	67.3
	100.0	100.0	**100.0**	100.0	**100.0**	100.0	100.0	100.0	100.0
Average occupancy *(%)*	**85.9**	86.3	**85.6**	85.3	**84.9**	85.6	85.4	85.6	85.7

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

We have implemented a number of short and longer-term tactics, which take a more strategic approach to identifying and meeting the program and service needs of each community in which we are located. Included in these initiatives are the establishment of Active Life Transition Units (ALTUs) that are upgraded suites targeted to attract our short-term rehabilitation residents. We currently have 14 ALTUs and plan to continue to expand the number of centers with ALTUs within certain of our centers.

EHSI's total skilled nursing center ADC declined by 10.9%, or 1,542 ADC, to 12,551 in the 2012 third quarter from 14,093 in the 2011 third quarter. Of this decline, 1,428 in lower ADC related to non same-facility operations consisting of the 21 skilled nursing centers leased to a third party in 2012, one skilled nursing center that was sold in May 2011, and the balance of the 114 decline in ADC related to a decline in same-facility census. Our average occupancy in the 2012 third quarter was 84.9% compared to 85.6% in the 2011 third quarter and 85.6% in the 2012 second quarter.

Our same-facility ADC of 12,353 in the 2012 third quarter was 114 below the 2011 third quarter level of 12,467 due to lower Skilled Mix ADC of 176 and private/other ADC of 14, partially offset by an increase in Medicaid ADC of 76. In comparison to the 2012 second quarter, our same-facility ADC was lower by four due to lower Skilled Mix ADC of 137, partially offset by an increase in private/other ADC of 27 and Medicaid ADC of 106. Our average same-facility occupancy was 84.8% this quarter compared to 84.9% in the 2011 third quarter and was unchanged from the 2012 second quarter.

Our same-facility Skilled Mix ADC represented 21.5% of our residents in the 2012 third quarter compared to 22.7% in the 2011 third quarter and 22.6% in the 2012 second quarter.

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

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

Canadian Operations

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

The following are ECI's average daily revenue rates and occupancy levels for the past eight quarters and the 2011 year.

	Q1		Q2		Q3		Q4		Year
	2012	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2010**	**2011**
Average revenue rate *($)*	**183.92**	181.16	**187.57**	182.94	**186.26**	181.66	191.00	183.97	184.25
Average occupancy *(%)*	**97.4**	96.4	**97.8**	96.7	**97.9**	97.5	97.2	98.0	96.9
Average same-facility occupancy *(%)*	**97.5**	97.8	**97.8**	97.8	**97.9**	98.0	97.6		97.8

Revenue from provincial programs represents approximately 66% of ECI's nursing home revenue during the year. ECI's average daily revenue rate increased by 2.5% to $186.26 in the 2012 third quarter from $181.66 in the 2011 third quarter. The majority of ECI's nursing home operations are in Ontario, which operates under a funding envelope system, under which a substantial portion of the revenue is tied to flow-through funding, and is therefore matched with the related costs for resident care in the periods in which they are incurred. As a result, ECI's average revenue rates fluctuate by quarter, and are generally at their lowest in the first quarter and at their highest in the fourth quarter. For further information on funding in Canada, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada".

In Canada, where the supply of long-term care beds historically has been very restricted in comparison to the United States, nursing home operators typically enjoy higher occupancy levels than operators in the United States. Our same-facility average occupancy in Canada, excluding one new leased center in Ontario and the three new centers and two closed centers in Alberta, was 97.9% in the 2012 third quarter compared to 98.0% in the 2011 third quarter. In terms of the quarterly trends throughout the year, slightly lower occupancy levels are to be expected during the winter months as a result of flu outbreaks which can lead to temporary freezes on admissions.

Revenue from provincial programs represented approximately 97% of ECI's home health care revenue in the first nine months of 2012 (2011 year – 97%). Our average daily home health care hours of service increased by 2.5% this quarter to 13,065 from 12,752 in the 2011 third quarter, and declined by 0.4% from 13,117 in the 2012 second quarter. For the first nine months of 2012 ParaMed provided 3,569,000 hours of home health care service (13,025 hours per day). For the 2011 year, ParaMed provided 4,634,000 hours of home health care service, or 12,695 hours per day, of which 95.1% was from business in Ontario and the remainder from our Alberta operations. Since 2004, we had been unable to compete for new government contracts in Ontario due to the government's freeze on the competitive bidding process. As previously announced, the Ontario government implemented a new model for home health care beginning October 1, 2012, that does not involve a bidding process. All Community Care Access Centre (CCAC) home care contracts within the province concluded on September 30, 2012, and new open-ended, flexible CCAC home care contracts commenced on October 1, 2012. ParaMed signed new open-ended contracts for all of its existing CCAC contracts. The government has indicated their intention to provide six months' notice of loss of a contract, and providers are to provide the CCAC with twelve months' notice of intention to give up a contract. The new service delivery model will place greater emphasis on quality of care and value than past arrangements, with service providers' performance evaluated based on these elements. Select providers, including ParaMed, are anticipated to participate in a proof of concept period to test the model and funding changes prior to March 31, 2013, which will involve a small number of the CCACs as early adopters. For further details, refer to the discussion under the heading "Update of Regulatory and Reimbursement Changes Affecting Revenue – Canada – Ontario Home Health Care Legislation and Funding".

IMPACT OF U.S. DOLLAR AND FOREIGN CURRENCY TRANSLATION

Impact on Financial Statements

The majority of our operations are conducted in the United States, which accounted for 64.8% of consolidated revenue from continuing operations in the first nine months of 2012 (2011 year – 66.7%). As a result, changes in the exchange rates used to translate the results of the U.S. operations to Canadian dollars can affect the comparison of the consolidated results.

The table below illustrates the positive/(negative) effect of changes in the average exchange rates used in translating the U.S. results for the 2012 second and third quarters and the 2011 year.

	Q2		Q3		Nine months ended September 30		Year	
	2012	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2010**
Average U.S./Canadian dollar exchange rate	**1.0103**	0.9681	**0.9956**	0.9807	**1.0023**	0.9781	**0.9891**	1.0299
Impact on Periods *(millions of dollars)*								
Revenue	**14.3**		**4.5**		**24.1**		(57.6)	
EBITDA	**1.2**		**0.1**		**1.8**		(5.5)	
Net earnings (loss)	**0.3**		**(0.3)**		**1.1**		1.1	
AFFO	**0.6**		**(0.2)**		**0.7**		(2.0)	
Same-facility Operations								
Revenue	**13.0**		**4.6**		**22.3**		(56.9)	
EBITDA	**1.0**		**0.1**		**1.5**		(5.5)	

The following table illustrates the contribution from our U.S. operations to selected line items of our financial results for the nine months ended September 30, 2012, and for the 2011 year, and the resulting impact of a one-cent change in the Canadian dollar against the U.S. dollar. However, a change in the exchange rate has had limited impact on the cash flow from our U.S. operations to fund distributions, because we had foreign currency forward contracts (FCFCs) in place until June 2011 (refer to discussion below under the heading "Impact of Foreign Currency Forward Contract Strategy on Distributions").

	Nine months ended September 30, 2012		Year 2011	
U.S. Operations	**Results**	**Impact of One-Cent Change in Exchange Rate [1]**	**Results**	**Impact of One-Cent Change in Exchange Rate [1]**
(millions of dollars)	*US$*	C$ (annualized)	*US$*	C$
Revenue	*995.4*	13.3	*1,411.1*	14.1
EBITDA	*77.2*	1.0	*135.8*	1.4
AFFO	*30.6*	0.4	*48.5*	0.5

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

The valuation of any FCFCs is marked to market and reported on our balance sheet based upon the current value of the future stream of converted funds. A fluctuation in the Canadian to U.S. dollar exchange rates and valuation of any FCFCs can result in unrealized gains or losses that are reported within our statement of earnings as part of "loss (gain) on foreign exchange and financial instruments". Gains or losses on the FCFCs are not subject to cash taxes until realized.

Impact of Foreign Currency Forward Contract Strategy on Distributions

We have a foreign currency hedging strategy whereby we monitor and consider entering into FCFCs to reduce the risks associated with changes in the U.S. dollar and the impact such changes could have on our Canadian dollar cash available for distribution. EHSI had a contract that matured in June 2011, which converted US$4.0 million into Canadian dollars on a monthly basis at the prevailing exchange rate at that time subject to a floor of 1.00 and a ceiling of 1.09 (whereby US$1.00 converts to C$1.09). Management continues to monitor the U.S. to Canadian dollar exchange rate and to consider future FCFCs to the extent that they may be beneficial to us.

ADJUSTED FUNDS FROM OPERATIONS

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

(millions of dollars unless otherwise noted)	Q1		Q2		Q3		Nine months ended September 30		Q4	Year
	2012	**2011**	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2011**
EBITDA	**49.4**	58.0	**43.6**	63.3	**37.3**	38.7	**130.3**	160.0	40.1	200.1
Depreciation for FFEC	**(5.8)**	(5.9)	**(6.3)**	(5.6)	**(5.7)**	(5.8)	**(17.8)**	(17.3)	(6.1)	(23.4)
Accretion costs	**(0.5)**	(0.5)	**(0.6)**	(0.5)	**(0.5)**	(0.5)	**(1.6)**	(1.5)	(0.5)	(2.0)
Interest expense, net	**(16.2)**	(21.5)	**(14.8)**	(22.1)	**(15.4)**	(21.9)	**(46.4)**	(65.5)	(19.8)	(85.3)
	26.9	30.1	**21.9**	35.1	**15.7**	10.5	**64.5**	75.7	13.7	89.4
Current income tax expense [2]	**(2.9)**	(9.4)	**(3.0)**	(11.0)	**(3.5)**	(8.8)	**(9.4)**	(29.2)	(1.8)	(31.0)
FFO (continuing)	**24.0**	20.7	**18.9**	24.1	**12.2**	1.7	**55.1**	46.5	11.9	58.4
Amortization of financing costs and accretion costs	**1.4**	1.9	**0.9**	2.9	**1.3**	4.1	**3.6**	8.9	2.5	11.4
Principal portion of government capital funding payments	**0.7**	0.6	**0.7**	0.7	**0.7**	0.7	**2.1**	2.0	0.6	2.6
Additional facility maintenance capital expenditures [3]	**1.0**	1.2	**(1.0)**	(1.5)	**(3.0)**	(3.3)	**(3.0)**	(3.6)	(4.0)	(7.6)
AFFO (continuing)	**27.1**	24.4	**19.5**	26.2	**11.2**	3.2	**57.8**	53.8	11.0	64.8
AFFO (discontinued) [4]	**–**	1.2	**–**	1.1	**–**	1.3	**–**	3.6	1.4	5.0
AFFO [5]	**27.1**	25.6	**19.5**	27.3	**11.2**	4.5	**57.8**	57.4	12.4	69.8
Per Basic Share/Unit [6] *($)*										
FFO (continuing)	**0.285**	0.249	**0.222**	0.290	**0.143**	0.020	**0.650**	0.559	0.142	0.701
AFFO (continuing)	**0.322**	0.294	**0.230**	0.315	**0.130**	0.037	**0.682**	0.646	0.131	0.777
AFFO	**0.322**	0.308	**0.230**	0.328	**0.130**	0.054	**0.682**	0.690	0.147	0.837
Per Diluted Share/Unit [6] *($)*										
FFO (continuing	**0.267**	0.236	**0.214**	0.271	**0.145**	0.039	**0.626**	0.546	0.143	0.689
AFFO (continuing)	**0.298**	0.274	**0.221**	0.292	**0.134**	0.055	**0.653**	0.621	0.134	0.755
AFFO	**0.298**	0.286	**0.221**	0.304	**0.134**	0.068	**0.653**	0.658	0.148	0.806
Distributions [6] *($)*										
Declared *(thousands)*	**17,729**	17,453	**17,825**	17,484	**17,922**	17,534	**53,476**	52,471	17,630	70,101
Declared per share/unit	**0.210**	0.210	**0.210**	0.210	**0.210**	0.210	**0.630**	0.630	0.210	0.840
Weighted Average Number of Shares/Units [6] *(thousands)*										
Basic	**84,347**	83,082	**84,805**	83,230	**85,260**	83,442	**84,806**	83,253	83,869	83,408
Diluted	**98,358**	96,895	**98,618**	96,980	**99,604**	97,255	**98,797**	97,045	97,682	97,205

(1) "EBITDA", "FFO", and "AFFO" are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS. Refer to the discussion of non-GAAP measures.

(2) Excludes current tax with respect to fair value adjustments, and gains or losses on foreign exchange, financial instruments, asset impairment, disposals and other items that are excluded from the computation of AFFO.

(3) Represents total facility maintenance capital expenditures less depreciation for furniture, fixtures, equipment and computers, or FFEC, already deducted in determining FFO.

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

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

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

AFFO Review

2012 THIRD QUARTER

AFFO from continuing operations was $11.2 million ($0.130 per basic share) in the 2012 third quarter compared to $3.2 million ($0.037 per basic share) in the same 2011 period. Excluding the increase in prior years' reserves of $11.0 million and $31.4 million, respectively, AFFO from continuing operations was $22.2 million ($0.260 per basic share) this period compared to $34.6 million ($0.414 per basic share) in the same 2011 period. Excluding a $0.1 million positive effect of a weaker Canadian dollar, AFFO from continuing operations declined by $12.5 million between periods. This decrease was primarily due to a decline in EBITDA of $22.1 million, largely due to the adverse impact of the 2011 CMS Final Rule along with lower U.S. census, partially offset by lower net interest costs and current income taxes. Excluding the impact of foreign exchange, net interest costs were lower by $3.8 million as a result of our debt refinancing. Current income taxes represented 21.9% of pre-tax funds from operations (FFO) this quarter compared to 83.5% in the 2011 third quarter, and were favourably impacted by the proportion of earnings between taxable and non-taxable entities, particularly the impact of the higher level of reserves recorded in our non-taxable captive in 2011, and the utilization of loss carryforwards. A discussion of EBITDA by segmented division can be found under the heading "2012 Third Quarter Financial Review".

AFFO in the 2012 second quarter was $19.5 million ($0.230 per basic share), or $25.1 million ($0.297 per basic share) excluding the $5.6 million increase in prior years' reserves. In comparison, AFFO this quarter of $22.2 million was lower by $2.7 million, excluding a $0.2 million negative effect of a stronger Canadian dollar. This decrease was due primarily to a decline in EBITDA of $0.5 million and an increase in facility maintenance capital expenditures. Current income taxes represented 21.9% of pre-tax FFO this quarter compared to 14.0% in the 2012 second quarter. However, excluding the prior years' reserves the effective tax rates were 12.8% this quarter compared to 11.2% in the 2012 second quarter. Facility maintenance capital expenditures were higher by $1.5 million, and are typically at their lowest in the first quarter and ramp up during the year.

2012 NINE MONTHS

AFFO from continuing operations was $57.8 million ($0.682 per basic share) in the first nine months of 2012, compared to $53.8 million ($0.646 per basic share) in the same 2011 period. Excluding the increase in prior years' reserves of $16.6 million and $31.4 million, respectively, AFFO from continuing operations was $74.4 million ($0.878 per basic share) this period compared to $85.2 million ($1.023 per basic share) in the same 2011 period. Excluding a $1.1 million positive effect of a weaker Canadian dollar, AFFO from continuing operations declined by $11.9 million between periods. This decrease was primarily due to a decline in EBITDA of $46.7 million, largely due to the adverse impact of the 2011 CMS Final Rule along with lower U.S. census, partially offset by lower net interest costs and current income taxes. Excluding the impact of foreign exchange, net interest costs were lower by $14.3 million as a result of our debt refinancing. Current income taxes represented 14.5% of pre-tax FFO this period compared to 38.5% in the first nine months of 2011, and were favourably impacted by the proportion of earnings between taxable and non-taxable entities, the utilization of non-capital loss carryforwards in Canada and favourable changes in timing differences between the periods. A discussion of EBITDA by segmented division can be found under the heading "2012 Nine Month Financial Review".

The effective tax rates on our FFO can be impacted by: adjustments to our estimates of annual timing differences, particularly when dealing with cash-based tax items versus accounting accruals; changes in the proportion of earnings between taxable and non-taxable entities; book-to-file adjustments for prior year filings; and the ability to utilize loss carryforwards. The restructuring of our Canadian legal entities, along with elimination of the income trust structure under the 2012 Conversion, has enhanced our ability to realize available non-capital loss carryforwards that will reduce our current Canadian income taxes to a nominal level for the balance of 2012 and 2013. As a result of the utilization of these non-capital loss carryforwards, and favourable book-to-file adjustments and timing differences, we anticipate that our annual effective tax rate on FFO for the 2012 year will be in the range of 14% to 18%.

Facility maintenance capital expenditures were $8.7 million in the 2012 third quarter, compared to $9.1 million in the 2011 third quarter and $7.3 million in the 2012 second quarter, representing 1.7%, 1.7% and 1.4% of revenue, respectively. For the first nine months of 2012, facility maintenance capital expenditures totalled $20.8 million compared to $20.9 million in the same 2011 period. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend between 1.5% and 2.0% of revenue annually, which is consistent with our objective to maintain and upgrade our centers. We are expecting to spend up to approximately $35 million in facility maintenance capital expenditures and approximately $50 million in growth capital expenditures in 2012.

DISTRIBUTION POLICY

The current policy of Extendicare is to pay dividends of $0.07 per share to the holders thereof on a monthly basis. The declaration and payment of future dividends is subject to the discretion of the 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 the Board determines that it would be in Extendicare's best interests, it may reduce, for any period, the amount and frequency of dividends to be distributed to holders of Common Shares.

Distributions declared in the first nine months of 2012 totalled $53.5 million, or $0.63 per share, representing approximately 93% of total AFFO of $57.8 million compared to approximately 91% in the same 2011 period. Excluding the impact of the increase in prior years' reserves for self-insured liabilities, distributions represented approximately 72% and 59% of total AFFO in the first nine months of 2012 and 2011, respectively. For the year ended 2011, distributions declared totalled $70.1 million, or $0.84 per unit, representing approximately 100% of total AFFO of $69.8 million.

Taxability of Dividends Made by Extendicare Inc.

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

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

Taxability of Distributions Made by Extendicare REIT

Management estimates that approximately 70% of the monthly distributions made by Extendicare REIT in the first half of 2012 will be characterized as tax-deferred returns of capital for Canadian residents. Such estimate is based on the organizational structure of the REIT, certain financial information, the current provisions of the Tax Act, published statements of the current administrative and assessing practices of the Canadian Revenue Agency (CRA), and the specific proposals to amend the Tax Act announced by the Minister of Finance (Canada) prior to the date hereof. The adjusted cost base of the REIT Units will generally be reduced by such non-taxable portion of distributions made to the unitholder (other than the non-taxable portion of capital gains). A unitholder will generally realize a capital gain to the extent that the adjusted cost base of the units would otherwise be a negative amount. To the extent that the remaining 30% of distributions of the REIT made in 2012 are taxed as dividends, those paid to Canadian residents will be eligible dividends under the Tax Act.

For U.S. tax purposes, Extendicare REIT elected to be classified as a corporation effective January 1, 2011. Extendicare REIT was not required to calculate its current or accumulated earnings and profits under U.S. federal income tax principles and accordingly, has not calculated either current or accumulated earnings and profits. Accordingly, under U.S. tax principles, all distributions of Extendicare REIT are required to be treated as non-qualified dividends.

SUMMARY OF QUARTERLY RESULTS

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

(thousands of dollars unless otherwise noted)	Q1		Q2		Q3		Q4	
	2012	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2010**
Revenue	**517,188**	516,553	**524,686**	517,246	**498,505**	528,457	531,826	529,102
EBITDA [(1)]	**49,373**	57,964	**43,637**	63,295	**37,305**	38,774	40,103	65,665
EBITDA margin	***9.5%***	*11.2%*	***8.3%***	*12.2%*	***7.5%***	*7.3%*	*7.5%*	*12.4%*
Earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes [(1)]	**9,912**	9,118	**6,384**	14,199	**(3,264)**	(13,981)	(2,350)	11,218
Average U.S./Canadian dollar exchange rate [(2)]	**1.0011**	0.9856	**1.0103**	0.9681	**0.9956**	0.9807	1.0217	1.0130

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

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

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

(thousands of dollars)	Q1		Q2		Q3		Q4	
	2012	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2010**
Net earnings (loss)	**49,006**	(8,394)	**3,675**	30,278	**(4,651)**	(34,383)	(17,897)	28,336
Add (Deduct):								
Fair value adjustment on convertible debentures, net of taxes	**(4,987)**	8,033	**(120)**	(7,576)	**(2,029)**	(9,566)	9,686	(8,783)
Fair value adjustment on Exchangeable LP Units, net of taxes	**–**	10,555	**–**	(7,305)	**–**	(10,468)	618	(3,437)
Loss (gain) on foreign exchange and financial instruments, net of taxes	**–**	(988)	**1,103**	(90)	**–**	308	115	(2,350)
Loss (gain) from asset impairment, disposals and other items, net of taxes	**423**	417	**1,726**	(672)	**3,847**	40,779	6,284	(2,034)
Distributions on Exchangeable LP Units, net of taxes	**–**	662	**–**	652	**–**	649	216	669
Discontinued operations, net of taxes	**(34,530)**	(1,167)	**–**	(1,088)	**(431)**	(1,300)	(1,372)	(1,183)
Earnings (loss) from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	**9,912**	9,118	**6,384**	14,199	**(3,264)**	(13,981)	(2,350)	11,218
Earnings (loss) before income taxes	**17,717**	(2,036)	**4,979**	37,213	**(491)**	(36,933)	(20,125)	38,999
Add (Deduct):								
Depreciation and amortization	**19,355**	19,200	**19,455**	18,694	**19,005**	19,096	19,587	18,775
Net finance costs	**11,661**	40,231	**16,393**	8,330	**13,944**	2,409	31,974	9,293
Loss (gain) from asset impairment, disposals and other items	**640**	569	**2,810**	(942)	**4,847**	54,202	8,667	(1,402)
EBITDA	**49,373**	57,964	**43,637**	63,295	**37,305**	38,774	40,103	65,665

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

Segmented EBITDA	**Q1**		**Q2**		**Q3**		**Q4**	
(thousands of dollars)	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2010**
U.S. operations *(US$)*	**33,721**	44,422	**26,239**	47,199	**17,191**	20,125	24,097	49,690
U.S. operations *(C$)*	**33,758**	43,782	**26,544**	45,713	**17,028**	19,803	25,064	50,490
Canadian operations	**15,615**	14,182	**17,093**	17,582	**20,277**	18,971	15,039	15,175
EBITDA	**49,373**	57,964	**43,637**	63,295	**37,305**	38,774	40,103	65,665

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

- Medicare and Managed Care admissions are usually the highest in the first and second quarters; begin to decline during the latter portion of the second quarter; and are generally at their lowest in the summer months as there tends to be fewer elective surgeries performed;
- Medicaid rate changes, including adjustments for CMI and provider taxes, occur with each state's fiscal year, which is July 1st for the majority of the major states in which EHSI operates, and October 1st for Michigan;
- Medicare rate changes generally occur October 1st (federal fiscal year), and typically include a market basket inflationary increase;
- Ontario long-term care providers generally receive annual acuity-based flow-through funding adjustments effective April 1st and accommodation funding increases July 1st, and Alberta long-term care providers generally receive annual inflationary rate increases and acuity-based funding adjustments on April 1st;
- independent actuarial reviews are conducted three times a year, in the second and third quarters and at year end, which may lead to a strengthening, or conversely, a release of the reserves for self-insured liabilities;
- utility costs are generally at their highest in the first quarter and their lowest in the third quarter, with variances between the two of as much as $3.5 million; and
- foreign currency exchange rate fluctuations between the U.S. and Canadian dollars and impact on translation of our U.S. operations from U.S. dollars to Canadian dollars.

Further details on the above can be found under the sections "Overview – Significant 2012 Events and Developments", "Key Performance Indicators", "Impact of U.S. Dollar and Foreign Currency Translation", "Other Significant Developments" and "Update of Regulatory and Reimbursement Changes Affecting Revenue".

2012 THIRD QUARTER FINANCIAL REVIEW

Consolidated Continuing Operations

(millions of dollars unless	**Q3**		**Q3/12 vs Q3/11**		**Q2**	**Q3/12 vs Q2/12**	
otherwise noted)	**2012**	**2011**	**$**	**%**	**2012**	**$**	**%**
Revenue	**498.5**	528.5	(30.0)	*(5.7)%*	524.7	(26.2)	*(5.0)%*
Operating expenses	**442.0**	471.6	(29.6)	*(6.3)%*	462.3	(20.3)	*(4.4)%*
Administrative costs	**16.5**	15.5	1.0	*6.5%*	16.0	0.5	*3.1%*
Lease costs	**2.7**	2.7	–	–	2.8	(0.1)	*(3.6)%*
EBITDA	**37.3**	38.7	(1.4)	*(3.6)%*	43.6	(6.3)	*(14.4)%*
EBITDA as a % of revenue	***7.5%***	*7.3%*			*8.3%*		
Average U.S./Canadian dollar exchange rate	**0.9956**	0.9807			1.0103		

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 0.9956 for the 2012 third quarter, 0.9807 for the 2011 third quarter and 1.0103 for the 2012 second quarter. However, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at the rates of exchange in effect at the time of the transactions.

HIGHLIGHTS *(variances exclude effect of foreign exchange)*

- Revenue was $498.5 million in the 2012 third quarter, and included a decline of $10.1 million from same-facility operations over the 2011 third quarter.
- Average daily revenue rates for Medicare Part A and Managed Care in the 2012 third quarter declined by 10.6% and 5.1%, respectively, over the 2011 third quarter, and increased by 2.4% and 0.9%, respectively, over the 2012 second quarter.
- EBITDA includes strengthening of prior years' reserves of $11.0 million in the 2012 third quarter.
- EBITDA, excluding reserve adjustments, was $48.3 million in the 2012 third quarter, $22.1 million lower than the 2011 third quarter, and $0.5 million lower than the 2012 second quarter.
- EBITDA margin, excluding reserve adjustments, was 9.7% in the 2012 third quarter compared to 13.3% in the 2011 third quarter and 9.4% in the 2012 second quarter.

CONSOLIDATED CONTINUING OPERATIONS COMPARED TO THE 2011 THIRD QUARTER

Consolidated revenue from continuing operations declined by $30.0 million to $498.5 million in the 2012 third quarter from $528.5 million in the 2011 third quarter. Non same-facility operations contributed $16.3 million to revenue this quarter and $40.8 million in the 2011 third quarter, for a net decline between quarters of $24.5 million. The non same-facility operations related to the impact of 27 centers and an assisted living wing, as follows: the 21 skilled nursing centers in Kentucky that were leased to a third party in 2012; a U.S. skilled nursing center that was sold in May 2011, and two Canadian nursing centers that closed in January and November 2011, partially offset by the addition of a new Canadian nursing center that was leased in May 2011, two new Canadian centers that opened in January and November 2011, and the designated assisted living wing of a new center that opened in February 2011. Excluding the $4.6 million positive effect of the weaker Canadian dollar, revenue from same-facility operations declined between periods by $10.1 million, with improvement in Canadian operations of $4.9 million offset by the impact of the 2011 CMS Final Rule and lower census levels on the U.S. operations. Details by segmented operations are discussed below.

Consolidated EBITDA from continuing operations was $37.3 million in the 2012 third quarter compared to $38.7 million in the 2011 third quarter, and represented 7.5% and 7.3% of revenue, respectively. Excluding the increase in prior years' reserve for self-insured liabilities of $11.0 million this quarter and $31.4 million in the same 2011 period, EBITDA was $48.3 million, or 9.7% of revenue, this quarter compared to $70.1 million, or 13.3% of revenue, in the 2011 third quarter. This represented a decline of $21.8 million between periods. Non same-facility operations generated EBITDA of $6.1 million in the 2012 third quarter compared to $7.4 million in the same 2011 period, for a net decline of $1.3 million between periods. Excluding a $0.2 million positive effect of a weaker Canadian dollar, same-facility EBITDA declined by $20.7 million, with an improvement in Canadian operations of $0.6 million, offset by a $21.3 million decline in U.S. operations. Details by segmented operations are discussed below.

Consolidated labour-related costs represented 73.1% of operating and administrative costs in the 2012 third quarter compared to 70.3% in the 2011 third quarter, and as a percentage of revenue, were 67.2% and 64.8%, respectively.

CONSOLIDATED CONTINUING OPERATIONS COMPARED TO THE 2012 SECOND QUARTER

Consolidated revenue from continuing operations declined by $26.2 million to $498.5 million in the 2012 third quarter from $524.7 million in the 2012 second quarter. Non same-facility operations contributed $16.3 million to revenue this quarter and $42.4 million in the 2012 second quarter, for a net decline between quarters of $26.1 million. Excluding a $4.5 million negative effect of a stronger Canadian dollar, growth from same-facility operations was $4.4 million, of which $2.5 million was from the U.S. operations and the balance from the Canadian operations. Details by segmented operations are discussed below.

Consolidated EBITDA from continuing operations was $37.3 million in the 2012 third quarter compared to $43.6 million in the 2012 second quarter, and represented 7.5% and 8.3% of revenue, respectively. Excluding the increase in prior years' reserves for self-insured liabilities of $11.0 million this quarter and $5.6 million in the 2012 second quarter, EBITDA was $48.3 million, or 9.7% of revenue, this quarter compared to $49.2 million, or 9.4% of revenue, in the 2012 second quarter.

This represented a decline of $0.9 million between periods. Non same-facility operations generated EBITDA of $6.1 million in the 2012 third quarter compared to $6.4 million in the 2012 second quarter, for a net decline of $0.3 million between periods. Excluding a $0.3 million negative effect of a stronger Canadian dollar, EBITDA from same-facility operations declined by $0.3 million. Details by segmented operations are discussed below.

Consolidated labour-related costs represented 73.1% of operating and administrative costs in the 2012 third quarter compared to 73.4% in the 2012 second quarter, and as a percentage of revenue, were 67.2% and 66.9%, respectively.

U.S. Continuing Operations

(millions of dollars unless otherwise noted)	**Q3 2012**		**Q3 2011**		**Q3/12 vs Q3/11**		**Q2 2012**		**Q3/12 vs Q2/12**	
	US$	**C$**	**US$**	**C$**	**US$**	**%**	**US$**	**C$**	**US$**	**%**
Revenue	**316.2**	*314.6*	359.1	*352.2*	(42.9)	*(11.9)%*	339.5	*343.1*	(23.3)	*(6.9)%*
Operating expenses	**285.9**	*284.5*	326.4	*320.0*	(40.5)	*(12.4)%*	300.8	*304.0*	(14.9)	*(5.0)%*
Administrative costs	**11.5**	*11.4*	10.9	*10.7*	0.6	*5.5%*	10.8	*11.0*	0.7	*6.5%*
Lease costs	**1.6**	*1.7*	1.7	*1.7*	(0.1)	*(5.9)%*	1.6	*1.6*	–	–
EBITDA	**17.2**	*17.0*	20.1	*19.8*	(2.9)	*(14.4)%*	26.3	*26.5*	(9.1)	*(34.6)%*
EBITDA as a % of revenue	***5.4%***		*5.6%*				*7.7%*			

U.S. CONTINUING OPERATIONS COMPARED TO THE 2011 THIRD QUARTER

Revenue from U.S. operations in its functional currency declined by US$42.9 million to US$316.2 million in the 2012 third quarter compared to US$359.1 million in the 2011 third quarter. The Kentucky operations were the only non same-facility operations that impacted these quarters, earning revenue of US$7.7 million this quarter compared to US$35.4 million in the 2011 third quarter, for a net decline of US$27.7 million. Revenue from same-facility operations declined by US$15.2 million between periods primarily due to lower average Medicare and Managed Care rates and lower census levels, partially offset by higher average Medicaid and private/other rates. The decline in our average Medicare and Managed Care rates reflected changes implemented by the 2011 CMS Final Rule. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

Same-facility Revenue: 2012 Third Quarter Compared to 2011 Third Quarter *(US$ millions)*	
(7.4)	– decrease in average skilled nursing center rates (decrease in Medicare $10.8 million and Managed Care $2.2 million, partially offset by an increase in Medicaid $4.6 million and private/other $1.0 million)
(7.3)	– decrease in skilled nursing center resident census (decrease in Medicare $7.3 million, Managed Care $1.0 million and private/other $0.3 million, partially offset by an increase in Medicaid $1.3 million)
(1.6)	– decrease in prior period revenue settlement adjustments (receipt of $0.2 million in 2012 versus $1.8 million in 2011)
0.8	– increase in nursing ancillary revenue
0.3	– increase in other revenue
(15.2)	

The operating, administrative and lease costs of our U.S. operations decreased by US$40.0 million to US$299.0 million this quarter compared to US$339.0 million in the 2011 third quarter. Excluding the increase in prior years' reserves for self-insured liabilities of US$11.0 million this quarter and US$32.1 million in the same 2011 period, costs were US$288.0 million this quarter compared to US$306.9 million in the 2011 third quarter. This represented a decline of US$18.9 million between periods. The Kentucky operations incurred costs of US$3.3 million this quarter compared to US$28.8 million in the 2011 third quarter, for a net decline of US$25.5 million between periods. Costs associated with same-facility operations increased by US$6.6 million and were affected primarily by an increase in the accrual for self-insured liabilities of US$3.3 million, a refund of prior years' charges of US$3.6 million recorded in the 2011 third quarter, higher state provider taxes of US$1.4 million and an increase in the accrual for share appreciation rights of US$1.2 million (a charge of US$0.4 million this quarter compared to a credit of US$0.8 million in the same 2011 period), partially offset by net reductions in other costs of US$2.9 million. Labour-related costs from total operations represented 66.9% of operating and administrative costs this quarter, compared to 63.8% in the 2011 third quarter, and as a percentage of revenue were 63.0% and 59.9%, respectively.

EBITDA from U.S. operations was US$17.2 million this quarter compared to US$20.1 million in the 2011 third quarter, and represented 5.4% and 5.6% of revenue, respectively. Excluding the increase in prior years' reserves for self-insured liabilities of US$11.0 million this quarter and US$32.1 million in the same 2011 period, EBITDA was US$28.2 million, or

8.9% of revenue, this quarter compared to US$52.2 million, or 14.5% of revenue, in the 2011 third quarter. This represented a decline of US$24.0 million between periods. EBITDA from non same-facility operations was lower by US$2.2 million between periods. EBITDA from same-facility operations declined by US$21.8 million, resulting from the decline in revenue of US$15.2 million and higher operating, administrative and lease costs of US$6.6 million, as previously discussed.

U.S. CONTINUING OPERATIONS COMPARED TO THE 2012 SECOND QUARTER

Revenue from U.S. operations in its functional currency declined by US$23.3 million to US$316.2 million in the 2012 third quarter compared to US$339.5 million in the 2012 second quarter. The Kentucky operations were the only non-same facility operations impacted these quarters, and they generated revenue of US$7.7 million this quarter compared to US$33.6 million in the 2012 second quarter for a net decline of US$25.9 million between periods. Revenue from same-facility operations was higher by $2.6 million and was largely impacted by the extra day this quarter and an increase in average rates, partially offset by a decline in census, as outlined below. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

Same-facility Revenue: 2012 Third Quarter Compared to 2012 Second Quarter *(US$ millions)*	
(3.3)	– decrease in skilled nursing center resident census (decrease in Medicare $5.5 million, and Managed Care $0.2 million, partially offset by an increase in Medicaid $1.8 million and private/other $0.6 million)
3.0	– One extra day in the period
2.8	– increase in average skilled nursing center rates (increase in Medicaid $2.0 million and Medicare $0.8 million)
0.1	– increase in other revenue
2.6	

The operating, administrative and lease costs of our U.S. operations decreased by US$14.2 million to US$299.0 million this quarter compared to US$313.2 million in the 2012 second quarter. Excluding the increase in prior years' reserves for self-insured liabilities of US$11.0 million this quarter and US$5.6 million in the 2012 second quarter, costs were US$288.0 million this quarter compared to US$307.6 million in the 2012 second quarter. This represented a decline of US$19.6 million between periods. The Kentucky operations incurred costs of US$3.3 million this quarter compared to US$28.6 million in the 2012 second quarter, for a net decline of US$25.3 million between periods. Costs associated with same-facility operations increased by US$5.7 million and included an increase in the accrual for self-insured liabilities of US$3.5 million and higher labour-related costs of US$3.0 million, partially offset by net cost reductions of US$0.8 million. Labour costs included an increase in the accrual for share appreciation rights of US$0.6 million, in which a charge of US$0.4 million was recorded this quarter compared to a credit of US$0.2 million in the 2012 second quarter. Labour-related costs from total operations represented 66.9% of operating and administrative costs this quarter, compared to 68.2% in the 2012 second quarter, and as a percentage of revenue were 63.0% and 62.6%, respectively.

EBITDA from U.S. operations was US$17.2 million this quarter compared to US$26.3 million in the 2012 second quarter, and represented 5.4% and 7.7% of revenue, respectively. Excluding the increase in prior years' reserves for self-insured liabilities of US$11.0 million this quarter and US$5.6 million in the 2012 second quarter, EBITDA was US$28.2 million, or 8.9% of revenue, this quarter compared to US$31.9 million, or 9.4% of revenue, in the 2012 second quarter. This represented a decline of US$3.7 million between periods. EBITDA from non same-facility operations was lower by US$0.6 million between periods. EBITDA from same-facility operations declined by US$3.1 million, resulting from the increase in revenue of US$2.6 million offset by higher operating, administrative and lease costs of US$5.7 million, as previously discussed.

Canadian Continuing Operations

(millions of dollars unless	**Q3**		**Q3/12 vs Q3/11**		**Q2**	**Q3/12 vs Q2/12**	
otherwise noted)	**2012**	**2011**	**$**	**%**	**2012**	**$**	**%**
Revenue	**183.9**	176.3	7.6	*4.3%*	181.6	2.3	*1.3%*
Operating expenses	**157.5**	151.6	5.9	*3.9%*	158.3	(0.8)	*(0.5)%*
Administrative costs	**5.1**	4.8	0.3	*6.3%*	5.0	0.1	*2.0%*
Lease costs	**1.0**	1.0	–	–	1.2	(0.2)	*(16.7)%*
EBITDA	**20.3**	18.9	1.4	*7.4%*	17.1	3.2	*18.7%*
EBITDA as a % of revenue	***11.0%***	*10.7%*			*9.4%*		

CANADIAN CONTINUING OPERATIONS COMPARED TO THE 2011 THIRD QUARTER

Revenue from Canadian operations grew by $7.6 million, or 4.3%, to $183.9 million in the 2012 third quarter from $176.3 million in the 2011 third quarter. Of this improvement, $6.5 million was derived from nursing and assisted living center operations and included an increase of $2.7 million from non same-facility operations. Growth from same-facility nursing and assisted living center operations was $3.8 million primarily due to funding enhancements. Revenue from home health care operations improved by $0.5 million this quarter, primarily due to a 2.5% increase in daily volumes, partially offset by lower average rates. Other revenue improved by $0.6 million.

Operating, administrative and lease costs increased by $6.2 million to $163.6 million this quarter from $157.4 million in the 2011 third quarter, of which $1.9 million was from non same-facility operations. Costs from same-facility operations increased by $4.3 million this quarter primarily due to higher costs of care, including labour-related costs of approximately $4.2 million. Labour costs included an increase in the accrual for share appreciation rights of $0.9 million, in which a charge of $0.3 million was recorded this quarter compared to a credit of $0.6 million in the 2011 third quarter. Labour-related costs from total operations represented 84.4% of operating and administrative costs in the 2012 third quarter compared to 84.0% in the 2011 third quarter, and as a percentage of revenue were 74.6% and 74.5%, respectively.

EBITDA from Canadian operations improved by $1.4 million to $20.3 million in the 2012 third quarter from $18.9 million in the 2011 third quarter and represented 11.0% and 10.7% of revenue, respectively. Non same-facility operations contributed $0.8 million to the improvement, while same-facility operations improved by $0.6 million, with higher revenue of $4.9 million in excess of cost increases of $4.3 million, as previously discussed.

CANADIAN CONTINUING OPERATIONS COMPARED TO THE 2012 SECOND QUARTER

Revenue from Canadian operations improved by $2.3 million, or 1.3%, to $183.9 million in the 2012 third quarter from $181.6 million in the 2012 second quarter. Revenue from nursing and assisted living center operations improved by $2.5 million of which $0.4 million resulted from non same-facility operations. Growth from same-facility operations of $2.1 million was primarily due to funding enhancements that took effect July 1, 2012, as well as timing of recognition of funding to match spending under the Ontario flow-through envelope system. Home health care revenue declined by $0.7 million primarily due to a 0.4% decrease in daily volumes and lower average rates. Other revenue improved by $0.5 million.

Operating, administrative and lease costs decreased by $0.9 million to $163.6 million this quarter from $164.5 million in the 2012 second quarter, all of which was from same-facility operations and related primarily to lower health care volumes and timing of spending. Labour-related costs increased by $0.9 million and included an increase in the accrual for share appreciation rights of $0.4 million, in which a charge of $0.3 million was recorded this quarter compared to a credit of $0.1 million in the 2012 second quarter. Labour-related costs from total operations represented 84.4% of operating and administrative costs in the 2012 third quarter compared to 83.4% in the 2012 second quarter, and as a percentage of revenue were 74.6% and 75.0%, respectively.

EBITDA from Canadian operations improved by $3.2 million to $20.3 million in the 2012 third quarter from $17.1 million in the 2012 second quarter, and represented 11.0% and 9.4% of revenue, respectively. Non same-facility operations contributed EBITDA of $1.7 million this quarter compared to $1.3 million in the 2012 second quarter, for a net improvement of $0.4 million between periods. Same-facility operations improved by $2.8 million, with higher revenue of $1.9 million and lower costs of $0.9 million, as previously discussed.

Depreciation and Amortization

Depreciation and amortization costs of $19.0 million in the 2012 third quarter were relatively unchanged from $19.1 million in the 2011 third quarter, primarily due to a $0.2 million negative effect of a weaker Canadian dollar, with the balance resulting from new centers opened in Canada, partially offset by closed or disposed properties.

Loss from Asset Impairment, Disposals and Other Items

Extendicare recorded a pre-tax loss from asset impairment, disposals and other items of $4.9 million in the 2012 third quarter compared to a pre-tax loss of $54.1 million in the same 2011 period. The 2012 third quarter charge of $4.9 million included a non-cash asset impairment charge of $2.8 million, a $1.0 million loss in connection with the Kentucky lease transaction, and other costs of $1.1 million related to debt settlements and the 2012 Conversion. The 2011 third quarter pre-tax loss of $54.1 million related to a non-cash asset impairment charge of $54.0 million in connection with the revaluation of our U.S. property and goodwill resulting from the 2011 CMS Final Rule, and $2.1 million in debt settlement costs, partially offset by a $2.0 million release of provisions for contingent liabilities. For further information, refer to *note 11* of the unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2012.

Net Finance Costs

Net finance costs of $13.9 million in the 2012 third quarter were $11.5 million higher than the 2011 third quarter level of $2.4 million. This was largely due to an unfavourable change in the fair value adjustments and foreign exchange of $18.7 million, partially offset by lower net interest costs of $6.5 million resulting from the debt refinancing, partially offset by increased debt in connection with the Alberta projects completed in 2011. The Exchangeable LP Units were fully redeemed in November 2011 for REIT Units. Therefore, the 2012 results include neither a fair value adjustment nor a distribution amount related to the Exchangeable LP Units.

The following table summarizes the components of net finance costs.

	Q3		Change	
(millions of dollars unless otherwise noted)	**2012**	**2011**	**$**	**%**
Interest, net				
Interest expense	**15.9**	23.8	(7.9)	*(33.2)%*
Interest revenue	**(0.5)**	(1.9)	1.4	*(73.7)%*
	15.4	21.9	(6.5)	*(29.7)%*
Accretion				
Accretion of decommissioning provisions	**0.4**	0.4	–	–
Other accretion	**0.1**	0.1	–	–
	0.5	0.5	–	–
Exchangeable LP Unit distributions	**–**	0.7	(0.7)	*(100.0)%*
Fair Value Adjustments and Loss (Gain) on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	**(2.0)**	(10.6)	8.6	*(81.1)%*
Fair value adjustment on Exchangeable LP Units	**–**	(10.5)	10.5	*(100.0)%*
Loss on foreign exchange and financial instruments	**–**	0.4	(0.4)	*100.0%*
	(2.0)	(20.7)	18.7	*(90.3)%*
Net finance costs	**13.9**	2.4	11.5	*479.2%*

Income Taxes

The tax provision from continuing operations was $4.6 million on a pre-tax loss of $0.5 million in the 2012 third quarter compared to a tax recovery of $1.2 million on a pre-tax loss of $36.9 million in the 2011 third quarter. The effective tax rates for each period were distorted by, among other things, the fair value adjustments, gains and losses from financial instruments, foreign exchange, asset impairment, disposals, and other items. As well, the effective tax rates of both quarters were impacted by the non-taxable adjustment to prior years' reserves for self-insured liabilities of $11.0 million this quarter and $31.4 million in the 2011 third quarter. Excluding these items, the effective tax rate was 41.9% this quarter compared to 39.0% in the 2011 third quarter. This change in rates was primarily due to the change in proportion of income among our taxable and non-taxable entities.

2012 NINE MONTH FINANCIAL REVIEW

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

	Nine months ended September 30							
	2012				2011			
(millions of dollars unless otherwise noted)	**U.S.**	**U.S.**	**Canada**	**Total**	**U.S.**	**U.S.**	**Canada**	**Total**
	(US$)				*(US$)*			
Revenue	*995.4*	**997.7**	**542.7**	**1,540.4**	*1,068.9*	1,045.5	516.8	1,562.3
Operating expenses	*879.5*	**881.5**	**471.6**	**1,353.1**	*915.2*	895.2	447.1	1,342.3
Administrative costs	*33.8*	**33.9**	**14.8**	**48.7**	*37.0*	36.2	15.7	51.9
Lease costs	*4.9*	**5.0**	**3.3**	**8.3**	*5.0*	4.8	3.3	8.1
	918.2	**920.4**	**489.7**	**1,410.1**	*957.2*	936.2	466.1	1,402.3
EBITDA	*77.2*	**77.3**	**53.0**	**130.3**	*111.7*	109.3	50.7	160.0
Depreciation and amortization	*43.8*	**43.9**	**13.9**	**57.8**	*44.3*	43.4	13.6	57.0
Loss (gain) from asset impairment, disposals and other items	*4.6*	**4.7**	**3.6**	**8.3**	*55.7*	55.8	(2.0)	53.8
Results from operating activities	*28.8*	**28.7**	**35.5**	**64.2**	*11.7*	10.1	39.1	49.2
Interest, net	*24.7*	**24.7**	**21.7**	**46.4**	*42.3*	41.4	24.1	65.5
Accretion	*1.3*	**1.3**	**0.3**	**1.6**	*1.2*	1.2	0.3	1.5
Distributions on Exchangeable LP Units	–	**–**	**–**	**–**	–	–	2.0	2.0
Fair value adjustments	–	**–**	**(7.1)**	**(7.1)**	–	–	(17.4)	(17.4)
Loss (gain) on foreign exchange and financial instruments	–	**–**	**1.1**	**1.1**	*(0.3)*	(0.3)	(0.3)	(0.6)
Net finance costs	*26.0*	**26.0**	**16.0**	**42.0**	*43.2*	42.3	8.7	51.0
Earnings from continuing operations before income taxes	*2.8*	**2.7**	**19.5**	**22.2**	*(31.5)*	(32.2)	30.4	(1.8)
Income tax expense	*4.8*	**4.7**	**4.4**	**9.1**	*10.0*	9.4	4.9	14.3
Earnings (loss) from continuing operations	*(2.0)*	**(2.0)**	**15.1**	**13.1**	*(41.5)*	(41.6)	25.5	(16.1)
Discontinued operations	*34.5*	**34.9**	**–**	**34.9**	*3.6*	3.6	–	3.6
Net earnings (loss)	*32.5*	**32.9**	**15.1**	**48.0**	*(37.9)*	(38.0)	25.5	(12.5)
Add (Deduct):								
Fair value adjustment on convertible debentures, net of taxes	–	**–**	**(7.1)**	**(7.1)**	–	–	(9.1)	(9.1)
Fair value adjustment on Exchangeable LP Units, net of taxes	–	**–**	**–**	**–**	–	–	(7.2)	(7.2)
Loss (gain) on foreign exchange and financial instruments, net of taxes	–	**–**	**1.1**	**1.1**	*(0.5)*	(0.5)	(0.3)	(0.8)
Loss (gain) from asset impairment, disposals and other items, net of taxes	*3.2*	**3.3**	**2.7**	**6.0**	*42.5*	42.6	(2.1)	40.5
Distributions on Exchangeable LP Units, net of taxes	–	**–**	**–**	**–**	–	–	2.0	2.0
Discontinued operations, net of taxes	*(34.5)*	**(34.9)**	**–**	**(34.9)**	*(3.6)*	(3.6)	–	(3.6)
Earnings from continuing operations before separately reported gains/losses and distributions on Exchangeable LP Units, net of taxes	*1.2*	**1.3**	**11.8**	**13.1**	*0.5*	0.5	8.8	9.3
Average U.S./Canadian dollar exchange rate				**1.0023**				0.9781

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were 1.0023 for the first nine months of 2012 and 0.9781 for the first nine months of 2011. However, separately reported items such as fair value adjustments, gains or losses related to financial instruments, foreign exchange, asset impairment, disposals and other items, are translated at the rates of exchange in effect at the time of the transactions.

Consolidated Continuing Operations

Consolidated revenue from continuing operations declined by $21.9 million to $1,540.4 million in the first nine months of 2012 from $1,562.3 million in the same 2011 period. Non same-facility operations contributed $100.6 million to revenue this period and $123.8 million in the same 2011 period, for a net decline between periods of $23.2 million. Excluding the $22.3 million positive effect of the weaker Canadian dollar, revenue from same-facility operations declined between periods by $21.0 million, with improvement in Canadian operations of $16.3 million offset by the impact of the 2011 CMS Final Rule and lower census levels on the U.S. operations. Details by segmented operations are discussed below.

Consolidated EBITDA from continuing operations declined by $29.7 million to $130.3 million in the first nine months of 2012 from $160.0 million in the same 2011 period, and was 8.5% and 10.2% of revenue, respectively. Excluding the increase in prior years' reserves for self-insured liabilities of $16.6 million in the first nine months of 2012 and $31.4 million in the same 2011 period, EBITDA was $146.9 million, or 9.5% of revenue, this period compared to $191.4 million, or 12.3% of revenue, in the same 2011 period. This represented a decline of $44.5 million between periods. Non same-facility operations generated EBITDA of $18.5 million in the first nine months of 2012 compared to $21.4 million in the same 2011 period, for a net decline of $2.9 million between periods. Excluding a $1.9 million positive effect of a weaker Canadian dollar, same-facility EBITDA declined by $43.5 million, of which $44.6 million was from the U.S. operations partially offset by a $1.1 million improvement in the Canadian operations. Details by segmented operations are discussed below.

Consolidated labour-related costs as a percentage of operating and administrative costs were 73.9% in the first nine months of 2012 compared to 72.9% in the same 2011 period, and as a percentage of revenue, were 67.2% and 65.0%, respectively.

U.S. Continuing Operations

Revenue from U.S. operations in its functional currency declined by US$73.5 million to US$995.4 million in the first nine months of 2012 compared to US$1,068.9 million in the same 2011 period. Non same-facility operations generated revenue of US$75.3 million this period compared to US$110.7 million in the same 2011 period, representing a decline of US$35.4 million between periods. Revenue from same-facility operations declined by US$38.1 million between periods primarily due to lower census levels and lower average Medicare and Managed Care rates, partially offset by higher average Medicaid and private/other rates and the extra day in 2012. The decline in our average Medicare and Managed Care rates reflects changes implemented by the 2011 CMS Final Rule. More information on revenue rates and census is provided under "Key Performance Indicators – U.S. Operations".

Same-facility Revenue: Nine Months 2012 Compared to Nine Months 2011 *(US$ millions)*	
(22.6)	– decrease in skilled nursing center resident census (decrease in Medicare $24.4 million, Managed Care $3.6 million, partially offset by an increase in Medicaid $5.3 million and private/other $0.1 million)
(21.5)	– decrease in average skilled nursing center rates (decrease in Medicare $32.2 million and Managed Care $5.3 million, partially offset by an increase in Medicaid $12.5 million and private/other $3.5 million)
(3.0)	– decrease in prior period revenue settlement adjustments ($0.2 million in 2012 versus $3.2 million in 2011)
4.5	– increase in nursing ancillary revenue
3.2	– one extra day in the period
1.3	– increase in other revenue
(38.1)	

The operating, administrative and lease costs of our U.S. operations declined by US$39.0 million to US$918.2 million in the first nine months of 2012 compared to US$957.2 million in the same 2011 period. Excluding the increase in prior years' reserves for self-insured liabilities of US$16.6 million this period and US$32.1 million in the same 2011 period, costs were US$901.6 million this period compared to US$925.1 million in the same 2011 period. This represented a decline of US$23.5 million between periods. Non same-store operations incurred costs of US$60.8 million this period compared to US$91.7 million in the same 2011 period, for a net decline of US$30.9 million between periods. Same-facility costs increased by US$7.4 million and were affected primarily by higher state provider taxes of US$5.8 million, increased reserves for self-insured liabilities of US$3.7 million, and higher labour-related costs of US$3.4 million, partially offset by net cost reductions of US$5.5 million. Labour-related costs included an increase in the accrual for share appreciation rights of US$0.3 million, in which a charge of US$0.3 million was recorded this period compared to nil in the same 2011 period. Costs for the first nine months of 2012 included a premium refund of US$3.5 million that was recorded in the 2012 first quarter. However, in comparison to the first nine months of 2011, this was offset by a vendor refund of US$3.6 million that was recorded in the 2011 third quarter. Labour-related costs from total operations represented 68.6% of operating and

administrative costs for the first nine months of 2012 compared to 67.4% in the same 2011 period, and as a percentage of revenue were 62.9% and 60.0%, respectively.

EBITDA from U.S. operations was US$77.2 million in the first nine months of 2012 compared to US$111.7 million in the same 2011 period, and represented 7.8% and 10.5% of revenue, respectively. Excluding the increase in prior years' reserves for self-insured liabilities of US$16.6 million this period and US$32.1 million in the same 2011 period, EBITDA was US$93.8 million, or 9.4% of revenue, this period compared to US$143.8 million, or 13.5% of revenue, in the same 2011 period. This represented a decline of US$50.0 million between periods. EBITDA from non same-facility operations was lower by US$4.5 million between periods. Same-facility operations declined by US$45.5 million, resulting from the decline in revenue of US$38.1 million and higher operating, administrative and lease costs of US$7.4 million, as previously discussed.

Canadian Continuing Operations

Revenue from Canadian operations grew by $25.9 million, or 5.0%, to $542.7 million in the first nine months of 2012 from $516.8 million in the same 2011 period. Of this improvement, $20.5 million was derived from nursing and assisted living center operations and included an increase of $9.6 million from non same-facility operations. Growth from same-facility nursing and assisted living center operations of $10.9 million was primarily due to funding enhancements. Revenue from home health care operations improved by $4.8 million primarily due to a 3.5% increase in daily volumes. Other revenue increased by $0.6 million between periods.

Operating, administrative and lease costs increased by $23.6 million to $489.7 million in the first nine months of 2012 from $466.1 million in the same 2011 period, of which $8.4 million was from non same-facility operations. Costs from same-facility operations increased by $15.2 million primarily due to higher labour-related costs of approximately $12.7 million. Labour-related costs included an increase in the accrual for share appreciation rights of $0.2 million, in which a charge of $0.2 million was recorded this period compared to nil in the same 2011 period. Labour-related costs from total operations represented 83.9% of operating and administrative costs in both the first nine months of 2012 and in the same 2011 period, and as a percentage of revenue were 75.2% in both periods.

EBITDA from Canadian operations improved by $2.3 million to $53.0 million in the first nine months of 2012 from $50.7 million in the same 2011 period, and represented 9.8% of revenue in both periods. Non same-facility operations contributed EBITDA of $4.0 million this period compared to $2.8 million in the first nine months of 2011, for a net improvement of $1.2 million between periods. Same-facility operations improved by $1.1 million resulting from higher revenue of $16.3 million partially offset by higher costs of $15.2 million, as previously discussed.

Depreciation and Amortization

Depreciation and amortization costs of $57.8 million in the first nine months of 2012 were higher by $0.8 million from $57.0 million in the first nine months of 2011 and included a $1.1 million negative effect of a weaker Canadian dollar.

Loss from Asset Impairment, Disposals and Other Items

Extendicare recorded a pre-tax loss from asset impairment, disposals and other items of $8.3 million in the first nine months of 2012 compared to a pre-tax loss of $53.8 million in the same 2011 period. The pre-tax loss of $8.3 million reported in 2012 included a non-cash asset impairment charge of $2.8 million, a loss of $3.6 million in connection with the Kentucky lease transaction, and other costs of $1.9 million related to debt settlements and the 2012 Conversion. The pre-tax loss of $53.8 million reported in 2011 included a non-cash asset impairment charge of $54.0 million in connection with the revaluation of our U.S. property and goodwill resulting from the 2011 CMS Final Rule, and $2.7 million in debt settlement costs, partially offset by a $0.5 million gain on the sale of property in Alberta and Michigan and a $2.4 million release of provisions for contingent liabilities. For further information, refer to *note 11* of the unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2012.

Net Finance Costs

The following table summarizes the components of net finance costs.

	Nine months ended September 30		Change	
(millions of dollars unless otherwise noted)	**2012**	**2011**	**$**	**%**
Interest, net				
Interest expense	**48.7**	69.2	(20.5)	*(29.6)%*
Interest revenue	**(2.3)**	(3.6)	1.3	*(36.1)%*
	46.4	65.6	(19.2)	*(29.3)%*
Accretion				
Accretion of decommissioning provisions	**1.3**	1.2	0.1	*8.3%*
Other accretion	**0.3**	0.3	–	–
	1.6	1.5	0.1	*6.7%*
Exchangeable LP Unit distributions	**–**	2.0	(2.0)	*(100.0)%*
Fair Value Adjustments and Loss (Gain) on Foreign Exchange and Financial Instruments				
Fair value adjustment on convertible debentures	**(7.1)**	(10.2)	3.1	*(30.4)%*
Fair value adjustment on Exchangeable LP Units	**–**	(7.2)	7.2	*(100.0)%*
Loss (gain) on foreign exchange and financial instruments	**1.1**	(0.7)	1.8	*(257.1)%*
	(6.0)	(18.1)	12.1	*(66.9)%*
Net finance costs	**42.0**	51.0	(9.0)	*(17.6)%*

Net finance costs of $42.0 million in the first nine months of 2012 were $9.0 million below the 2011 level for the same period of $51.0 million. Net interest costs decreased by $19.2 million primarily due to our debt refinancing, partially offset by increased debt in connection with the Alberta projects completed in 2011 and a $0.6 million negative effect of the weaker Canadian dollar. The change in the fair value adjustments and loss (gain) on foreign exchange and financial instruments was unfavourable by $12.1 million between periods. The Exchangeable LP Units were fully redeemed in November 2011 for REIT Units. Therefore, the 2012 results include neither a fair value adjustment nor a distribution amount related to the Exchangeable LP Units.

Income Taxes

The tax provision from continuing operations was $9.1 million on pre-tax earnings of $22.2 million in the first nine months of 2012 compared to a tax provision of $14.3 million on a pre-tax loss of $1.8 million in the same 2011 period. The effective tax rates for each period were distorted by, among other things, the fair value adjustments, gains and losses from financial instruments, foreign exchange, asset impairment, disposals, and other items. The effective tax rate on earnings from continuing operations before separately reported items was 46.7% this period compared to 74.1% in the first nine months of 2011. As well, the effective tax rates of both periods were impacted by the non-taxable adjustment to prior years' reserves for self-insured liabilities of $16.6 million this period and $31.4 million in the same 2011 period. Excluding these items, the effective tax rate was 27.8% this period compared to 39.5% in the same 2011 period. This decline in rates was primarily due to the change in proportion of income among our taxable and non-taxable entities.

OTHER SIGNIFICANT DEVELOPMENTS

The discussion under the heading "Overview – Significant 2012 Events and Developments", summarizes the impact of the following items: the 2012 corporate conversion; the 2012 Medicare update; the 2012 Kentucky lease transaction; provision for self-insured liabilities; the 2011/2012 refinancing plan; the EHSI Credit Facility and the 2011 CMS Final Rule. This section provides a summary of other developments that have impacted the financial results or operations of Extendicare for 2012 in comparison to 2011.

Development Projects

COMPLETED PROJECTS (2011)

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

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

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

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

PROJECTS UNDER DEVELOPMENT

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

	New Centers			**Owned/Leased Centers to Close**	
Development Projects (as at September 30, 2012)	**Estimated Completion Date**	**No. of Centers**	**No. of Beds**	**No. of Centers**	**No. of Beds**
Canada – Owned Long-term Care Centers					
Sault Ste. Marie, Ontario	Q1/13	1	256	(2)	(263)
Timmins, Ontario	Q2/13	1	180	(1)	(119)
		2	**436**	**(3)**	**(382)**

Ontario Redevelopment Projects – Awarded

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

The cost of the two Ontario projects is estimated to be $80 million, of which $39.7 million had been spent to September 30, 2012. Conventional financing for approximately 88% of the total estimated cost for the two projects was secured at the end of October 2011. In addition, we will receive capital funding from the government of approximately $2.0 million annually

over a 25-year period. The combined annual EBITDA of the three existing owned centers (387 beds) for 2011 was approximately $2.8 million. It is anticipated that upon completion of the projects the incremental EBITDA for the three centers (536 beds) will be approximately $2.0 million, excluding the capital funding for the two new centers (436 beds).

Financing Activity

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

CANADA

2011 Mortgage Activity – Development Projects

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

In October 2011, ECI secured conventional long-term financing on its Sault Ste. Marie and Timmins projects in Ontario for up to $41.3 million and $28.6 million, respectively. The first two years of the loans are for construction with interest-only payments, following which the loans will be amortized over 25 years. The Sault Ste. Marie and Timmins loans contain fixed rates for the full 27-year term of 5.637% and 5.558%, respectively, and a requirement to maintain a minimum debt service coverage ratio.

UNITED STATES

Sovereign Loans – June 2011

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

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

Divestitures and Assets Held for Sale

Extendicare continually assesses the performance of its asset portfolio, and for those assets that fail to meet operating and financial standards, a decision may be made to dispose of the asset. Assets to be disposed of are recorded at the lower of the carrying value or estimated fair value net of disposal costs. During 2011, Extendicare classified its U.S. group purchasing operations as discontinued operations as a result of its pending sale in January 2012, as discussed further below.

2012 ACTIVITY

As at September 30, 2012, Extendicare had assets, net of liabilities, held for sale with a net book value of $2.6 million consisting of two closed nursing centers in Washington and Alberta, and two Ontario nursing centers to be closed upon completion of new centers, compared to $1.4 million at December 31, 2011.

In January 2012, EHSI finalized and closed on the sale of its group purchasing organization, or GPO, for cash proceeds of US$56.0 million, resulting in a pre-tax gain of $56.5 million (US$55.7 million), or an after-tax gain of $34.9 million (US$34.5 million). An agreement in principle had been reached in December 2011 between EHSI and Navigator Group Purchasing, a subsidiary of Managed Health Care Associates, Inc., resulting in the reclassification of our U.S. GPO operations to discontinued operations at the end of 2011.

2011 ACTIVITY

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

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

Economic Environment

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

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

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

STATE, PROVINCIAL AND FEDERAL FUNDING AND REGULATORY PRESSURE

Reductions in Medicaid, Medicare and provincial funding for long-term care due to the economic downturn could have a material adverse effect on our earnings. Our business is highly labour intensive, with labour costs representing approximately 74% of our consolidated operating costs for the first nine months of 2012 (2011 year – 73%). As a result of resident care needs and regulatory requirements, we have limited ability to reduce or manage our labour costs. In addition, any escalation of regulatory pressure by CMS, state or provincial level government agencies could have a negative impact on our operating costs and thereby reduce our earnings.

A number of states in which we operate have faced severe budgetary shortfalls since 2009, resulting in reductions in Medicaid funding or increases at rates below inflation. The temporary increase in funding for state Medicaid programs, through the federal medical assistance percentage, or FMAP funding increase, ended on June 30, 2011. As a result, a number of states are facing considerable financial pressures that could result in future Medicaid rate reductions, despite some economic improvement in certain regions.

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

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

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

In the U.S., Medicare and Managed Care funded residents were the source of approximately 82% of our admissions in 2011. Over the past three years, our average skilled nursing center occupancy rates have declined from 87.9% in 2009 to 86.0% in 2010 and 85.7% in 2011. However, due to our strategic focus on short-term rehabilitation residents, our Skilled Mix census as a percentage of our total center census has improved over the past three years from 21.9% in 2009 to 22.1% in 2010 and 22.8% in 2011.

The global economic downturn and continuing slow recovery has reduced disposable income of individuals, reduced employment and resulted in a general restraint by the public on health care spending. We believe the decline we have experienced in Medicare and total admissions was in part due to individuals deferring hospital elective surgery and the

resulting reduction in required post-acute care. Our future earnings could be eroded further should the level of admissions decrease as a result of a reduction in the financial resources or health insurance coverage of our prospective residents.

Another reason for the decline in skilled nursing center occupancy rates has been the concerted effort by state Medicaid programs to shift potential residents to home care programs and assisted living centers along with Managed Care programs constraining the period of coverage in skilled nursing centers in order to reduce costs to the Medicaid program.

In response to the decline in short-term admissions in the U.S., we have refocused and refined our strategic marketing plans, are working on strategic alliances within the marketplaces in which we operate, and have invested to increase the number of rehabilitation suites within our portfolio to increase our market share in communities where we anticipate returns on our investments that meet our criteria. Included in these initiatives are the establishment of Active Life Transition Units, which are upgraded suites within our centers targeted to attract short-term rehabilitation residents. Since launching the program in 2009, we have completed 14 ALTUs and plan to continue to expand the number of ALTUs within certain of our centers.

Legal Proceedings and Regulatory Actions

Extendicare and its consolidated subsidiaries are defendants in actions brought against them from time to time in connection with their operations. Recently adopted U.S. health care reform legislation is calling for more government oversight of the long-term care industry and operators are experiencing an increase in government investigations, audits and scrutiny of their operations. It is not possible to predict the ultimate outcome of the various proceedings at this time or to estimate additional costs that may result. However, based on current knowledge, management does not believe that liabilities, if any, arising from pending litigation will have a material adverse effect on the consolidated financial position, or results of operations of Extendicare.

As previously disclosed, EHSI has received subpoenas from the U.S. Department of Health and Human Services (DHHS), Office of the Inspector General (OIG), relating to the possible submission of claims that may be in violation of the U.S. Social Security Act and to the provision of rehabilitation services. EHSI and its subsidiaries believe that they are in material compliance with the requirements imposed on them by the U.S. Social Security Act, and intend to furnish all requested information and to cooperate with the OIG in its investigations. The DHHS, OIG, CMS and other federal, state and provincial enforcement agencies may conduct additional investigations related to our business in the future that may, individually or in the aggregate, have a material adverse effect on the business or financial condition of Extendicare.

The provision of health care services is subject to complex laws and regulations at the federal, state and provincial government levels, including laws that are intended to prevent health care fraud and abuse. On an ongoing basis, long-term care providers are subject to surveys, inspections, audits and investigations by various government authorities to ensure compliance with applicable laws and licensure requirements. In such circumstances, Extendicare cooperates in responding to information requests and takes the necessary corrective actions and, where appropriate, estimates costs that may result from such investigations to the extent such costs are predictable or determinable.

Canadian and U.S. Income Tax Updates

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

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

UPDATE OF REGULATORY AND REIMBURSEMENT CHANGES AFFECTING REVENUE

Extendicare's earnings are highly reliant on government funding and reimbursement programs, both in the U.S. and in Canada, and the effective management of staffing and other costs of operations, which are strictly monitored by government regulatory authorities. Given that we operate in a labour-intensive industry, where labour-related costs account for a significant portion of our operating and administrative costs (first nine months of 2012 – 74.7%; 2011 year – 72.8%), government funding constraints could have a significant adverse effect on our results from operations and cash flows. Management is unable to predict whether governments will adopt changes in their funding and reimbursement programs, and if adopted and implemented, what effect such changes will have on Extendicare.

All long-term care providers are subject to surveys, inspections, audits and investigations by government authorities to ensure compliance with applicable laws and licensure requirements of the federal, state and/or provincial funding programs. Nursing centers must comply with applicable regulations which, depending on the jurisdiction in which they operate, may relate to such things as staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental and other standards. The government review process is intended to determine compliance with survey and certification requirements, and other applicable laws. Remedies for survey deficiencies can be levied based upon the scope and severity of the cited deficiencies. Remedies range from the assessment of fines to the withdrawal of payments under the government funding programs. Should a deficiency not be addressed through a plan of correction, a center can be decertified from the funding program. As at September 30, 2012, we had certain centers under plans of correction at EHSI, but no centers had been decertified. While it is not possible to estimate the final outcome of the required corrective action, Extendicare has accrued for known remedial costs.

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

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

United States

The majority of Extendicare's operations are in the United States where 64.8% of its revenue from continuing operations was earned in the first nine months of 2012 (2011 year – 66.7%). EHSI receives payment for its services and products from the federal (Medicare) and state (Medicaid) medical assistance programs, Managed Care organizations (including HMO and preferred provider organizations), commercial insurers, the Department of Veterans Affairs, as well as from private payors. During 2011, approximately 53% of our U.S. resident admissions were Medicare funded and approximately 29% were Managed Care funded.

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

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

MEDICARE FUNDING

Market Basket Annual Increases

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

As announced by CMS on July 27, 2012, the net market basket increase for October 2012 was 1.8%, which consisted of a market basket increase of 2.5% minus a productivity adjustment of 0.7%. We estimate that the impact of this 1.8% rate increase will provide us with additional Medicare revenue of approximately US$6.2 million per annum.

The net market basket increase in each of October 2011 and 2010 was 1.7%. The October 2011 funding changes included a market basket update of 2.7% minus a productivity adjustment of approximately 1.0%. The October 2010 net 1.7% increase represented a 2.3% market basket increase, less a 0.6% forecasting error adjustment. We estimated that this net rate increase of 1.7% would increase our annual Medicare revenue by approximately US$6.8 million. These market basket increases were prior to the impact of the implementation of MDS 3.0 and RUG-IV in October 2010, and the 2011 CMS Final Rule implemented in October 2011, that included a parity adjustment, the elimination of group therapy and changes in the assessment process, as discussed below.

Medicare Reimbursement Changes Effective October 1, 2011

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

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

- a parity adjustment of an estimated aggregate reduction of 11.1% (a 12.6% recalibration of the CMI, partially offset by a market basket increase net of a productivity adjustment);
- changes to group therapy, which has been defined to be four patients who are simultaneously performing similar activities, and minutes are allocated;
- implementation of Change of Therapy Medicare-required assessments, or "OMRAs", whenever a patient's RUG-IV classification changes;
- clarification that End of Therapy (EOT) OMRAs must be completed following three consecutive calendar days without therapy services;
- implementation of the EOT-Resumption of therapy (EOT-R) OMRAs, in place of a Start-of-Therapy OMRAs, in cases where the resumption of therapy is no more than five consecutive calendar days after the last day of therapy provided, and there has been no change in the RUG-IV classification; and
- implementation of a new assessment to be completed every seven calendar days to update current therapy provided, regardless of whether there has been a significant change in condition.

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

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

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

- Prevented a 27.4% cut in Medicare physician rates proposed by CMS to begin on March 1, 2012, and instead freezes payment rates at their current level until December 31, 2012.
- Extended the therapy caps exception process through December 31, 2012 (see "Therapy Caps and Medicare Part B Rates" below).
- Reduced reimbursement for bad debts for dually eligible beneficiaries (Medicare and Medicaid eligible) from 100% to 88% in calendar year 2013, 76% in calendar year 2014 and ultimately to 65% in calendar year 2015. For dually eligible residents, who qualify as such because they lack the resources to pay their Part A co-insurance amounts, long-term care operators bill the Medicaid program for unpaid amounts. In certain states, the Medicaid program reimburses the operator for unpaid amounts, whereas if they do not, the operator can obtain reimbursement through the Medicare program by submitting unpaid claims through their annual filing of cost reports. In the majority of states where EHSI operates, the Medicaid program does not reimburse its centers for unpaid Part A co-insurance and therefore, EHSI files for reimbursement of approximately US$16 million per annum in reimbursable bad debts. The phased-in reduction of ultimately 35% over three years will result in an annual reduction of revenue to EHSI of approximately US$1.9 million in the first year, reaching approximately US$5.6 million in the third year. This is essentially cutting the Medicare rates of the nursing centers upon commencement of the co-insurance period, being 20th day of the resident's stay. Separately, EHSI obtains reimbursable bad debts for non-dually eligible Part A co-insurance bad debts of approximately US$0.6 million that is currently reimbursed at 70% that will be reduced to 65% in 2012.

Therapy Caps and Medicare Part B Rates

Since 2006, CMS has attempted to implement a cap on Part B therapy services for physical and speech therapy. However, lobbying efforts have been successful in preventing their implementation through U.S. Congressional action that established exceptions for individuals who were able to prove medical necessity for the therapy.

Effective January 1, 2012, CMS recommended an annual cap per eligible Part B recipient of US$1,880 for physical and speech therapy and a second cap of US$1,880 for occupational therapy. However, the exemption process to the therapy caps was extended for a further year to December 31, 2012, by the *Middle Class Tax Relief and Job Creation Act of 2012* (H.R. 3630) for individuals who were able to prove medical necessity for the therapy.

Effective October 2012, CMS established a requirement for pre-approval by a physician of claims over US$3,700 for physical and speech therapy and a second approval process for claims over US$3,700 for occupational therapy. Approval or denial of therapy services beyond the cap is determined on an individual basis and therefore the impact cannot be precisely determined. If 100% of the claims over US$3,700 were denied, the loss of revenue to us is estimated to be US$2 million for the fourth quarter of 2012, or US$8 million on an annualized basis. It is uncertain whether this interim requirement will extend beyond 2012 as further changes were proposed effective January 1, 2013, as discussed below.

In July 2012, CMS announced, in conjunction with the implementation of Medicare physician fee rates, a 31% reduction of Medicare Part B rates to commence January 1, 2013. The impact of the 31% Part B rate reduction on EHSI's therapy revenue is estimated to be US$11 million per annum. We continue to dialogue with policymakers about the impact of the Part B rate reduction and therapy caps on access to care and quality of life for our residents. The impact of these therapy caps may be mitigated to a certain extent by reductions in staffing and, in some cases, residents paying for these services.

Effective January 1, 2011, CMS implemented the application of the multiple procedure reduction policy that reduced EHSI's Medicare Part B inpatient and outpatient therapy revenue during 2011 by approximately 7.5%, or approximately US$3.2 million.

2013 House Budget Proposal

On March 21, 2012, House Budget Chairman Paul Ryan (R-WI) released his budget proposal for FY 2013 (the "House Budget Proposal"). The House Budget Proposal serves as a blueprint for setting monetary targets for savings. The committees of jurisdiction, Ways & Means for Medicare, and Energy & Commerce for Medicaid, must put together separate legislation to meet the savings targets through cuts to these programs. Most notably, the House Budget Proposal would transition Medicaid from an entitlement to a state block grant giving states the spending authority on the use of federal funds and Medicare would be transitioned to a voucher system to supplement the purchase of private health

insurance. Workers currently under the age of 55, beginning in 2023, would be given a choice of private plans competing alongside the traditional fee-for-service option on a newly created Medicare Exchange. Medicare would provide a premium-support payment either to pay for or offset the premium of the plan chosen by the senior. The bill would also repeal the *Patient Protection and Affordable Care Act* (H.R. 3590), which is discussed below. The repeal of H.R. 3590 remains a possibility if there is a change in the U.S. Presidency and Senate control following the 2012 election.

Budget Control Act of 2011 and Sequestration

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

The special Joint Select Committee on Deficit Reduction, referred to as the "Super Committee" was to propose legislation no later than January 15, 2012, to reduce spending by the additional US$1.2 trillion. As the Super Committee was unable to make a recommendation and U.S. Congress failed to pass legislation, a process of sequestration which, if not overturned, will automatically reduce Medicare funding by 2% beginning January 2, 2013. A 2% Medicare funding reduction resulting from sequestration is estimated to reduce our revenue and EBITDA by approximately US$7 million per annum.

2012 President's Budget

In February 2011, the U.S. President released the 2012 fiscal year budget (the "President's Budget"). The significant item within the President's Budget impacting the long-term care sector is the proposed reduction in the Medicaid Provider Tax Threshold. Commencing in 2015, the Medicaid Provider Tax Threshold would be reduced in phases over a three-year period. In the interim, the maximum percentage would be allowed to rise to 6.0% from 5.5% on October 1, 2011. Commencing in fiscal year (FY) 2015, the percentage would be phased down to: 4.5% in FY 2015; 4.0% in FY 2016; and 3.5% in FY 2017 and beyond. Provider taxes provide a significant source of FMAP funding and therefore could have a negative effect on state budgets during the phase-down period.

2010 Health Care Reform Legislation Remains a Significant Factor

In March 2010, historic health care reform legislation, the *Patient Protection and Affordable Care Act* (H.R. 3590), or "PPACA", was enacted into law at a cost of US$940 billion over 10 years. Amendments to the PPACA were enacted into law on March 30, 2010, with the passage of the *Health Care Education Affordability Act* (HCEAA), which contains several changes to the PPACA. The legislation is complex and there is considerable controversy surrounding its passage. In June 2012, the U.S. Supreme Court upheld the constitutionality of most of the provisions of the PPACA. However, the implementation of PPACA could be impacted by future legislation depending on the results of the 2012 fall elections.

It is generally believed that additional amendments may be introduced to address certain unintended consequences of the sweeping legislation before it is fully implemented in 2014. In addition, various government agencies will be required to issue regulations to properly implement the new legislation, which could have a significant impact on individuals, health care providers and employers. At this point in time, management is not able to determine the final form of the health care reform changes, nor estimate the impact of such on the business, results of operations and financial condition of Extendicare.

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

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

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

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

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

The additional following provisions were included in the final act:

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

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

(iii) DHHS must submit a Medicare value-based purchasing plan for skilled nursing centers by October 1, 2011; and

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

In addition, the health care reform legislation requires all individuals to have a minimum level of health care coverage and requires employers to provide health coverage, with certain stipulations, for employees. The legislation will increase the number of individuals with health care insurance coverage by mandating all individuals to obtain coverage by 2014 through their employer or directly through insurance companies or marketplace "exchanges". For employers, health care coverage must provide a minimum credible coverage and the employee's portion of the coverage must be affordable based upon the employee's income. An employer tax is applied if the employer does not provide any coverage to its employees, or if the employees opt out of the offered coverage and seek a tax credit for insurance purchased from the "exchanges". Some provisions, most notably the elimination of lifetime and annual limits, the prohibition on the denial of coverage due to pre-existing health conditions, and coverage of dependent children on a parent's health insurance coverage up to the age of 26, took effect for EHSI on January 1, 2011.

EHSI currently offers health care coverage to all of its qualifying employees under several different programs tailored to meet an individual's budget and risk tolerance. Approximately 65% of EHSI employees have joined one of EHSI's programs. There has been no material impact of the legislation on our health plan costs as a result of certain plan changes that we implemented to date. While it is difficult to quantify the future financial impact of the new requirements due to potential changes in legislation being considered, we believe that the mitigation strategies and options provided to our employees will result in no material increase (beyond modest inflationary adjustments) in the cost of providing employee health care coverage in 2012. The legislation has additional requirements slated for 2014. Presently, it remains uncertain whether EHSI's coverage will meet the proposed minimum requirements and whether incremental costs will be incurred to meet the proposed standards. We are not able to estimate the impact at this time for the reasons outlined above. We anticipate that modifications to the legislation will continue to be made before its final implementation in 2014.

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

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

MEDICAID FUNDING

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

Annual Medicaid Rate Increases

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

The July 1, 2012, Medicaid rates have been issued for Idaho, Ohio, Oregon, Pennsylvania and Washington. The net Medicaid funding for these states, defined as Medicaid rates less provider taxes, increased by approximately 0.2%, or US$0.6 million on an annualized basis. The Indiana and Wisconsin net Medicaid funding changes have not been issued, but are anticipated to increase by 3.5%, or US$3.9 million on an annualized basis, retroactive to July 1, 2012. The October 1, 2012, Medicaid rates have been issued for Minnesota and the net Medicaid funding for this state has decreased by approximately 1.3%, or US$0.5 million on an annualized basis. The Michigan and West Virginia Medicaid funding changes have not been issued, but are anticipated to increase by approximately 6.8%, or US$6.1 million on an annualized basis. The January 1, 2012, net Medicaid funding for Delaware decreased by approximately 0.4%, or US$0.1 million on an annualized basis.

The 2012 net Medicaid funding, as of the respective dates for all 11 states in which EHSI operates, is anticipated to increase by 2.0%, or US$10.0 million on an annualized basis (2011 – net increase of 1.1%, or US$5.2 million, excluding Kentucky). This estimate could be impacted by CMI changes and Medicaid occupancy changes, along with other factors.

Canada

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

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

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

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

Ontario is ECI's largest market for both its long-term care and home health care services. Funding for Ontario long-term care centers is based on reimbursement for the level of care assessed to be required by the residents, in accordance with scheduled rates. The provincial government allocates funds through "funding envelopes", specifically: nursing and personal care; programs and support services; and accommodation (which includes a sub-envelope for food). The funding for the nursing and personal care envelopes is generally adjusted annually based on the acuity of residents as determined by a classification assessment of resident care needs. The nursing and personal care, programs and support services, and food envelopes are "flow-through" envelopes, whereby any deviation in actual costs from scheduled rates is either absorbed by the provider (if actual costs exceed funding allocations) or is returned to the provincial government (if actual costs are below funding allocations). With respect to the accommodation envelope, providers retain any excess funding received over costs incurred. The province sets the rates for standard accommodation, as well as the maximum amounts that a provider can charge for semi-private and private accommodation (preferred accommodation). The accommodation rates are substantially paid for by the resident; however, the province guarantees funding for standard accommodation through resident subsidies. Overall funding is occupancy-based, but once the average occupancy level of 97% or higher is achieved, operators receive 100% funding. During 2011, if the average occupancy fell below 97%, but remained above 85%, the center was funded based on actual occupancy +3%, and if it fell below 85%, the funding was based on actual occupancy. For 2012, the province is extending occupancy protection for levels between 90-97% on a graded scale with those between 90-94% receiving +1% and those between 94-97% receiving +2%. In total, ECI's Ontario nursing centers averaged 98% occupancy during 2011, with only two of its centers averaging slightly below 97%.

ONTARIO LONG-TERM CARE LEGISLATION

Ontario Redevelopment Program

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

ECI owns 23 nursing centers with 3,572 class "C" beds and leases one center with 95 interim beds that require redevelopment to meet the new standards. The first round of submissions for approval under the redevelopment plan began in July 2009. There has been no announcement on the timing of the second round of submissions, which was expected to take place in mid-2011. Under the first phase of the redevelopment program, ECI received approval to redevelop 382 beds and is reviewing its remaining buildings to determine the priorities for redevelopment over future phases. Should ECI decide to replace or redevelop all of its remaining class "C" beds, management estimates that the total capital outlay will be in the range of $375 million to $475 million, depending on a number of factors including the cost of construction. Management estimates that approximately 20% to 25% of the total cost will be required to be funded by equity. ECI may choose not to replace certain of its centers and in other cases, form strategic partnerships with other providers for the replacement of their centers.

ONTARIO LONG-TERM CARE FUNDING

All Ontario long-term care centers have implemented a new resident assessment instrument – minimum data set, or RAI-MDS. In April 2010, the Ontario government began using the RAI-MDS 2.0 version to drive a new case-mix classification methodology using 34 categories under a RUGs-based funding model. This RUGs model will tie resident needs to costs of care in a more impartial and transparent way. Twenty-seven of ECI's centers have now been affected by this change and were fully transitioned to the new funding model by April 2012. ECI's remaining seven homes began transitioning to the new funding model in April 2012, and will have completely transitioned by April 2015.

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

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

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

In October 2012, the Ontario government announced changes that will improve the funding and related managerial flexibilities to all long-term care providers. Currently, long-term care providers refund to the Ontario government underspent amounts, or conversely absorb the loss of any overspent amounts, for each of the flow-through envelopes. Effective January 1, 2013, long-term care operators will be able to use underspent funds in the nursing or program envelopes to offset pressures in any other flow-through envelope. In addition, certain other changes were made to provide long-term operators with funding flexibilities. Extendicare has successfully managed to control its under or overspending in the past; however, we welcome these changes.

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

ALBERTA LONG-TERM CARE LEGISLATION AND FUNDING

In Alberta, a new activity-based funding system for continuing care centers commenced on April 1, 2010. However, Alberta Health Services (AHS) continues to adjust the formulas and the accountabilities. The funding model includes a separate pool for quality incentives funding (QIF) that represents a "quality bonus" awarded to centers meeting or exceeding a set of pre-determined quality criteria. The QIF program was implemented on April 1, 2011, as part of the fiscal 2011-2012 funding, and is subject to further development as quality information and indicators become available. In each of the past two fiscal years, the QIF program has consisted of four pre-determined indicators that were used to determine an operator's eligibility for 0.2% of its government funding. The quality indicators may include such things as: family satisfaction survey results; accreditation status; immunization rates; medication reconciliations; and the implementation of quality improvement initiatives based on the RAI-MDS indicators.

Effective April 1, 2012, the Alberta government provided funding increases to long-term care providers that included a base funding increase of 3.5%, and additional changes based on the CMI levels of the residents. ECI estimates that its funding has improved by an average of 4.9% representing annual revenue of approximately $4.0 million (April 2011 – $2.7 million).

In October 2012, the Alberta government announced a 5% increase in the long-term care accommodation fees (the portion paid directly by the residents), effective January 1, 2013, to recognize the rising costs of delivering accommodation and related services. The last time the accommodation fees increased was in February 2011 at a rate of 3%. ECI estimates that the 5% increase in 2013 will contribute additional annual revenue of approximately $1.3 million.

ONTARIO HOME HEALTH CARE LEGISLATION AND FUNDING

ECI is a major private-sector provider of home health care services in Canada through ParaMed, which operates in Alberta and Ontario. Ontario is ParaMed's largest market, representing approximately 96% of its revenue in the first nine months of 2012.

The 2011 Ontario Budget included a 3% funding increase for home health care. It is not clear how the additional funding has been utilized by the CCACs and consequently how it has impacted home health care providers, such as ParaMed.

The Ontario home health care competitive bidding process for contracts had been frozen since 2004 while the government underwent a study to improve the procurement model, and during this period, existing contracts were extended. In June 2012, the Ontario government announced the implementation of a new model for home health care that will not involve a bidding process. All CCAC home care contracts within the province concluded on September 30, 2012, and new open-ended, flexible CCAC home care contracts commenced on October 1, 2012. ParaMed signed new open-ended contracts for all of its existing CCAC contracts. The government has indicated their intention to provide six months' notice of loss of a contract, and providers are to provide the CCAC with twelve months' notice of intention to give up a contract. The new service delivery model will place greater emphasis on quality of care and value than past arrangements, with service providers' performance evaluated based on these elements.

Under the new model, funding will be outcome-based and designed to promote consolidated care for clients in order to address needs and realize improved outcomes. It is expected that integrated care for defined population groups (such as hip and knee replacement and wound care) will commence no later than January 2013 with a small percentage of clients, gradually increasing over the next two years. The introduction of reimbursement for care will begin by April 1, 2013, on the basis of outcomes achieved for these particular population groups. This is a change from the current service delivery model that is fee-for-service, based on client referrals for a single program, with a set number of visits and reimbursement based on each completed visit. Consequently, the new funding model will place greater emphasis on quality of care, value and outcomes, than past arrangements. Select providers, including ParaMed, are anticipated to participate in a proof of concept period to test the model and funding changes prior to March 31, 2013, which will involve a small number of the CCACs as early adopters.

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

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

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

At September 30, 2012, Extendicare had cash and cash equivalents of $171.4 million compared with $80.0 million at December 31, 2011, representing an increase of $91.4 million. Cash on hand at September 30, 2012, included the net proceeds of $104.8 million from the issue of the 2019 Debentures in September 2012, of which $94.0 million were used to redeem the 2013 Debentures in October 2012. Excluding the September debt offering, cash declined from the beginning of the year, largely due to cash used in connection with the refinancing of a significant portion of our U.S. debt, partially offset by the proceeds from the sale of the U.S. group purchasing operations. Cash pledged of $24.1 million (US$24.5 million) is excluded from our available cash balance as it relates to US$10.2 million held by RBC as collateral against a letter of credit and US$14.3 million held in escrow pursuant to the HUD regulatory agreements for working capital purposes.

Sources and Uses of Cash	**Three months ended September 30**		**Nine months ended September 30**		**Year**
(thousands of dollars unless otherwise noted)	**2012**	**2011**	**2012**	**2011**	**2011**
Cash provided by operating activities, before working capital changes and interest and income taxes	**50,112**	62,902	**147,855**	189,139	238,547
Net change in operating assets and liabilities					
Accounts receivable	**2,085**	(501)	**17,446**	8,144	(10,545)
Other current assets	**3,996**	(699)	**380**	(6,319)	(11,210)
Accounts payable and accrued liabilities	**(7,981)**	138	**(35,152)**	(15,785)	(4,525)
	(1,900)	(1,062)	**(17,326)**	(13,960)	(26,280)
Interest and taxes paid					
Interest paid	**(11,801)**	(17,956)	**(43,277)**	(61,063)	(83,531)
Interest received	**535**	1,824	**2,300**	3,651	4,278
Income taxes paid	**(5,802)**	(3,734)	**(22,089)**	(18,727)	(26,235)
	(17,068)	(19,866)	**(63,066)**	(76,139)	(105,488)
Net cash from operating activities	**31,144**	41,974	**67,463**	99,040	106,779
Net cash from investing activities	**(26,196)**	(18,793)	**134**	(47,497)	(67,906)
Net cash from financing activities	**94,613**	(86,318)	**25,452**	(62,573)	(227,243)
Foreign exchange gain (loss) on U.S. cash held	**(1,555)**	14,418	**(1,628)**	8,864	629
Increase (decrease) in cash and cash equivalents	**98,006**	(48,719)	**91,421**	(2,166)	(187,741)
Cash and cash equivalents at beginning of period	**73,433**	314,312	**80,018**	267,759	267,759
Cash and cash equivalents at end of period	**171,439**	265,593	**171,439**	265,593	80,018
Average U.S./Canadian dollar exchange rate	**0.9956**	0.9807	**1.0023**	0.9781	0.9891

Net cash from operating activities was a source of $67.5 million in the first nine months of 2012 compared to $99.0 million in the same 2011 period, representing a decline of $31.5 million, primarily due to the decline in earnings. As previously discussed EBITDA, excluding the increase in prior years' reserves for self-insured liabilities, has declined by $44.5 million between periods.

Net cash from investing activities was a source of $0.1 million in the first nine months of 2012 compared to a use of cash of $47.5 million in the same 2011 period. The 2012 activity reflected the sale of our U.S. group purchasing operations for net cash proceeds of $56.3 million, partially offset by expenditures for property, equipment and software. The 2011 activity reflected expenditures for property, equipment and software and the acquisition of a previously leased skilled nursing center for $7.3 million, partially offset by the sale of two properties for net cash proceeds of $4.8 million.

Purchases of property, equipment and software were $50.4 million in the first nine months of 2012 compared to $43.7 million in the same 2011 period. Growth capital expenditures, excluding acquisitions, were $29.9 million compared to $22.9 million in the first nine months of 2011, and related to the construction of new beds, building improvements or capital costs aimed at earnings growth. Maintenance capital expenditures, which are the capital costs to sustain and upgrade existing property and equipment assets, were $20.8 million in the first nine months of 2012 compared to $20.9 million in the same 2011 period, representing 1.4% and 1.3% of revenue, respectively. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend between 1.5% and 2.0% of revenue annually on maintenance capital expenditures, which is consistent with our objective to maintain and upgrade our centers. We are

projecting to spend up to approximately $35 million in facility maintenance capital expenditures and $50 million in growth capital expenditures in 2012.

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

Purchase of Property, Equipment and Software	Three months ended September 30		Nine months ended September 30		Year
(thousands of dollars unless otherwise noted)	**2012**	**2011**	**2012**	**2011**	**2011**
Growth expenditures	**15,479**	9,263	**29,921**	22,962	33,528
Facility maintenance	**8,704**	9,072	**20,806**	20,882	30,975
Deduct: capitalized interest	**(157)**	(106)	**(347)**	(160)	(195)
	24,026	18,229	**50,380**	43,684	64,308
Average U.S./Canadian dollar exchange rate	**0.9956**	0.9807	**1.0023**	0.9781	0.9891

Net cash from financing activities was a source of cash of $24.5 million in the first nine months of 2012 compared to a use of cash of $62.6 million in the same 2011 period. During the first nine months of 2012, debt issuances exceeded debt repayments by $106.4 million and restricted cash increased by $7.2 million as a result of the U.S. refinancing plan. As well, Extendicare made cash distributions of $42.6 million and increased its investments held for self-insured liabilities by $19.3 million. For information on the change in long-term debt, refer to "Liquidity and Capital Resources – Long-term Debt".

Reconciliation of Cash Provided by Operating Activities to AFFO

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

Reconciliation: Operating Cash to AFFO	Q1		Q2		Q3		Nine months ended September 30		Q4	Year
(millions of dollars)	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2012**	**2011**	**2011**	**2011**
Cash provided by operating activities	**17.5**	29.0	**18.8**	28.1	**31.1**	42.0	**67.4**	99.1	7.7	106.8
Add (Deduct):										
Net change in operating assets and liabilities, including interest and taxes	**(6.1)**	(3.4)	**11.8**	9.2	**1.6**	(6.7)	**7.3**	(0.9)	23.4	22.5
Current tax on fair value adjustments, gain/loss on foreign exchange, financial instruments, asset impairment, disposals and other items	**21.3**	–	**(1.0)**	0.5	**(0.6)**	(0.9)	**19.7**	(0.4)	(2.4)	(2.8)
Net provisions and payments for self-insured liabilities	**(1.1)**	3.6	**(3.5)**	(4.7)	**(13.1)**	(22.1)	**(17.7)**	(23.2)	(7.0)	(30.2)
Exchangeable LP Unit distributions	–	0.7	–	0.6	–	0.7	–	2.0	0.2	2.2
Depreciation for FFEC	**(5.8)**	(5.9)	**(6.3)**	(5.6)	**(5.7)**	(5.8)	**(17.8)**	(17.3)	(6.1)	(23.4)
Additional facility maintenance capital expenditures [2]	**1.0**	1.2	**(1.0)**	(1.5)	**(3.0)**	(3.3)	**(3.0)**	(3.6)	(4.0)	(7.6)
Principal portion of government capital funding payments	**0.7**	0.6	**0.7**	0.7	**0.7**	0.7	**2.1**	2.0	0.6	2.6
Other	**(0.4)**	(0.2)	**–**	–	**0.2**	(0.1)	**(0.2)**	(0.3)	–	(0.3)
AFFO	**27.1**	25.6	**19.5**	27.3	**11.2**	4.5	**57.8**	57.4	12.4	69.8

(1) "AFFO" is not a recognized measure under GAAP and does not have a standardized meaning prescribed by GAAP. Refer to the discussion of non-GAAP measures.

(2) Represents total facility maintenance capital expenditures less depreciation for furniture, fixtures, equipment and computers (FFEC) already deducted in determining FFO.

Capital Structure

(millions of dollars unless otherwise noted)	Nine months ended September 30, 2012	Year 2011
Shareholders'/Unitholders' Equity		
Common Shares	**463.9**	–
REIT Units	**–**	453.1
Equity portion of convertible debentures	**4.8**	–
Contributed surplus	**0.1**	0.1
	468.8	453.2
Accumulated deficit at beginning of year	**(386.2)**	(287.5)
Net earnings (loss) for the period	**48.0**	(30.4)
Other/adjustment to prior year distribution of ALC	**–**	(0.4)
Dividends declared on Common Shares	**(17.9)**	–
Distributions declared on REIT Units	**(35.6)**	(67.9)
Accumulated deficit at end of period	**(391.7)**	(386.2)
Accumulated other comprehensive loss	**(25.6)**	(18.7)
Shareholders'/Unitholders' equity	**51.5**	48.3
U.S./Canadian dollar exchange rate *(at period end)*	**0.9832**	1.0170

Share/Unit Information *(thousands)*	October 31, 2012	September 30, 2012	December 31, 2011
Common Shares/REIT Units (TSX symbol: EXE) [(1)]	**85,640.2**	**85,508.5**	84,121.5

[(1)] Closing market value per the TSX on October 31, 2012, was $8.17.

The closing rates used to translate assets and liabilities of the U.S. operations were 0.9832 at September 30, 2012, and 1.0170 at December 31, 2011. As a result of the stronger Canadian dollar at September 30, 2012, the assets of Extendicare's U.S. operations decreased by approximately $45.2 million, partially offset by a decrease in the liabilities of approximately $37.5 million, with the net change in foreign currency translation of $7.7 million included in accumulated other comprehensive loss. Every one-cent increase (decrease) in the Canadian dollar against the U.S. dollar would impact the net assets of our U.S. operations by approximately $2.6 million, and would be reflected as a change in foreign currency translation adjustments in accumulated other comprehensive loss.

DISTRIBUTIONS

In the first nine months of 2012, we generated AFFO of $64.6 million and declared monthly distributions of $0.07 per share/unit totalling $53.5 million that were paid out from February 15, 2012, to October 15, 2012. The portion distributed in cash was $42.9 million and $10.6 million was by way of shares/units issued under a distribution reinvestment plan. A total of 1,400,635 Common Shares/REIT Units were issued during the first nine months of 2012 through the distribution reinvestment plan.

During 2011, monthly distributions to holders of REIT Units and Exchangeable LP Units of $0.07 per unit were declared totalling $70.1 million, of which $60.2 million was distributed in cash and $9.9 million was by way of units issued under a distribution reinvestment plan. A total of 1,125,603 REIT and Exchangeable LP units were issued during 2011 through the distribution reinvestment plan.

There are a number of factors that affect the quarterly funds generated for distribution that our Board takes into consideration in determining the monthly distributions for the year. Factors affecting quarterly trends in earnings are discussed under the headings "Adjusted Funds from Operations", "Summary of Quarterly Results" and "2012 Third Quarter Financial Review".

In spite of the recent and potential for further U.S. funding reductions and the strengthening of our reserves for self-insured liabilities, the Board has made a determination to maintain distributions at the current level of $0.07 per share per month. The Board will continue to review the distribution policy on a regular basis, taking into consideration factors as they arise.

The declaration and payment of future distributions is subject to 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.

NORMAL COURSE ISSUER BID

On July 5, 2012, Extendicare received the approval of the TSX to commence a normal course issuer bid (the "Bid") to purchase for cancellation up to 4.0 million Common Shares, representing approximately 4.8% of the public float on July 1, 2012. The Bid commenced on July 9, 2012, and provides Extendicare with flexibility to repurchase Common Shares for cancellation until July 8, 2013, or on such earlier date as the Bid is complete. In July 2012, Extendicare acquired for cancellation 13,600 Common Shares at a cost of $0.1 million (average cost of $7.81 per share).

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

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

LONG-TERM DEBT

Long-term debt, including current portion, was $1,200.6 million at September 30, 2012, and was net of $30.3 million of financing costs compared with $1,134.4 million at December 31, 2011. The current portion of long-term debt was $121.9 million at September 30, 2012, and included the 2013 Debentures with a carrying value of $93.6 million that were fully redeemed in October 2012. The current portion at the end of 2011 was $192.7 million and included the May 2012 CMBS Financing of $111.8 million (US$109.9 million) that was repaid in full in February 2012 as part of the debt refinancing plan. Further details on the debt refinancing are discussed under the heading "Overview – Significant 2012 Events and Developments – 2011/2012 Refinancing Plan".

The following summarizes the changes in the carrying amounts of long-term debt for nine months ended September 30, 2012 and for the 2011 year.

Continuity of Long-term Debt *(millions of dollars)*	**Nine months ended September 30, 2012**	**Year 2011**
Long-term debt at beginning of year, prior to financing costs	**1,156.6**	1,255.9
Issue of long-term debt		
Mortgages	**166.4**	390.5
2019 Debentures (net of $5.0 million allocated to equity)	**105.0**	**–**
PrivateBank loans	**–**	9.9
Construction loans	**20.0**	1.9
Notes payable/other	**1.1**	0.1
Net issue (repayment) on the EHSI Credit Facility	**(46.7)**	35.7
Repayment of long-term debt	**(144.3)**	(551.2)
Revaluation of convertible debentures carried at fair value	**(7.1)**	0.6
Change due to period-end foreign exchange rate	**(20.1)**	13.2
	1,230.9	1,156.6
Financing costs at end of period	**(30.3)**	(22.2)
Long-term debt at end of period	**1,200.6**	1,134.4
Less: current portion	**(121.9)**	(192.7)
	1,078.7	941.7

Details of the components, terms and conditions of long-term debt are provided in *note 7* of the unaudited interim condensed consolidated financial statements for the three and nine months ended September 30, 2012. Extendicare and its subsidiaries are in compliance with all of their respective financial covenants as at September 30, 2012.

Interest Rates and Aggregate Debt Maturities

In order to meet Extendicare's monthly distributions, management has limited the amount of debt that may be subject to changes in interest rates. As a result, all but $39.8 million of our long-term debt outstanding at September 30, 2012, excluding financing costs and equity allocation, was at fixed rates. The variable-rate debt related to US$6.4 million drawn on EHSI's Credit Facility and US$34.1 million drawn on the PrivateBank loans.

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

The weighted average interest rate of our long-term debt was approximately 5.2% at September 30, 2012 (5.7% for our Canadian operations and 4.6% for U.S. operations), compared to 5.5% at December 31, 2011. The weighted average term to maturity of our long-term debt, including finance lease obligations, was 17.2 years as at September 30, 2012 (7.3 years for our Canadian operations and 28.5 years for our U.S. operations), compared to 14.5 years at December 31, 2011. Excluding our finance lease obligations, the weighted average term to maturity of our long-term debt was 17.6 years (5.8 years for our Canadian operations and 29.0 years for our U.S. operations).

Our consolidated interest coverage ratio based on our results for the first nine months of 2012, which reflects the full impact of the 2011 CMS Final Rule and the bulk of our interest savings, was 2.8 times (2011 year – 2.4 times). Interest coverage is defined as EBITDA divided by net interest.

ACCRUAL FOR SELF-INSURED LIABILITIES

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

At September 30, 2012, the accrual for self-insured general and professional liabilities was $95.4 million compared to $79.4 million at the beginning of the year, representing an increase of $16.0 million. The current period provision, net of claims payments, increased the accrual by $17.7 million, with the balance of the change due to the impact of the weaker Canadian dollar and accretion of the discount. Provisions recorded in the first nine months of 2012 and 2011 for potential general and professional liability claims were $34.8 million and $49.2 million, respectively. Payments for self-insured liabilities were $17.1 million in the first nine months of 2012 and $26.0 million in the same 2011 period.

The results of the 2012 third quarter independent actuarial review necessitated the strengthening of our prior years' reserves this quarter by $11.0 million (US$11.0 million), along with an incremental increase in the level of reserves for the current year. The strengthening of our prior years' reserves was primarily attributable to claims in the State of Kentucky and settlement of certain pre-2012 claims in other states. We had anticipated that following our exit from Kentucky, which has accounted for more than 50% of our provision for self-insured liabilities over the past two years, our provision for self-insured liabilities would be reduced by approximately US$12 million per annum. However, an increase in new claims in the quarter in other states has resulted in an actuarial projection that required an additional provision of US$3.5 million in the quarter.

Of the $34.8 million (US$34.8 million) in provisions for self-insured liabilities recorded in the first nine months of 2012, $16.6 million (US$16.6 million) related to the strengthening of our prior years' reserves, of which $5.6 million was recorded in the 2012 second quarter and $11.0 million in the 2012 third quarter. In comparison, in the same 2011 period, our provision for self-insured liabilities was $49.2 million (US$50.3 million), of which $31.4 million (US$32.1 million) related to prior years' reserves. For the year ended December 31, 2011, our provision for self-insured liabilities was $65.3 million (US$66.0 million), of which $42.8 million (US$43.3 million) related to prior years' reserves.

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

Most of the risks that Extendicare self-insures are long-term in nature and accordingly, claims payments for any particular policy year occur over a long period of time. However, management estimates and allocates a current portion of the accrual for self-insured liabilities on the statement of financial position. As at September 30, 2012, management estimated that $25.4 million of the accrual for self-insured general and professional liabilities will be paid within the next year. The timing of payments is not directly within management's control and therefore, estimates could change in the future.

Within our Bermuda-based captive insurance company, we hold investments sufficient to support the accrual for self-insured liabilities and to meet the required statutory solvency and liquidity rations. These invested funds are reported in other assets and totalled $100.9 million at September 30, 2012, compared to $83.6 million at December 31, 2011. This increase of $17.3 million included a cash injection of US$8.6 million into our captive insurance company in the 2012 first quarter to ensure the captive was adequately capitalized for regulatory purposes. Management believes there are sufficient cash resources to meet estimated current claims payment obligations.

CONTRACTUAL OBLIGATIONS

The table below provides summary information about the contractual obligations as at September 30, 2012. Due to the uncertainty as to the timing of payments to be made with respect to certain obligations, the table excludes our self-insured liabilities and decommissioning provisions, totalling $95.4 million and $26.2 million, respectively, as at September 30, 2012, and also excludes our defined benefit pension plan obligations, which are described more fully below.

Contractual Obligations *(millions of dollars)*	**Total**	**To the end of 2012**	**2013**	**2014**	**2015**	**2016**	**After 2016**
Extendicare convertible debentures (face value)	**315.7**	91.8	–	113.9	–	–	110.0
Canadian Subsidiary Operations							
Long-term debt	**229.7**	3.0	44.1	17.2	11.0	17.3	137.1
Finance lease obligations	**111.4**	1.0	4.5	4.9	5.2	5.6	90.2
Operating lease obligations	**8.4**	0.6	1.8	1.7	1.2	0.9	2.2
Purchase obligations	**43.1**	13.4	29.7	–	–	–	–
United States Subsidiary Operations [(1)]							
Long-term debt	**562.4**	6.3	46.3	9.4	16.0	10.1	474.3
Finance lease obligations	**15.2**	0.3	1.0	1.0	0.6	–	12.3
Operating lease obligations	**29.3**	1.3	4.7	4.4	3.8	3.7	11.4
Purchase obligations	**10.0**	10.0	–	–	–	–	–

(1) Obligations denominated in U.S. dollars are translated to Canadian dollars at a rate of 0.9832.

In addition to the operating lease amounts identified in the table above, EHSI remains party to ALC's master leases with LTC Properties, Inc. (LTC) following the 2006 Arrangement. For further details on these commitments, refer to "Off-balance Sheet Arrangements".

Defined Benefit Pension Plan Obligations

The contractual obligations table excludes our defined benefit pension plan obligations, none of which had funding requirements as at December 31, 2011. The accrued benefit liability on our balance sheet as at September 30, 2012, was $35.8 million (December 31, 2011 – $35.2 million). We currently have defined benefit registered and supplementary plans covering certain executives, both of which have been closed to new entrants since 2000. The registered defined benefit plan was fully funded with plan assets of $5.7 million and accrued benefit obligations of $7.8 million as at September 30, 2012 (December 31, 2011 – $5.6 million and $7.6 million, respectively). The accrued benefit obligations of the supplementary plan were $33.6 million as at September 30, 2012 (December 31, 2011 – $33.2 million). We do not set aside assets in connection with the supplementary plan and the benefit payments will be paid from cash from operations. The benefit obligations under the supplementary plan are secured by letters of credit totalling $42.7 million as at September 30, 2012 (December 31, 2011 – $40.0 million). The expected annual benefit payments under the supplementary pension plan that will be funded from cash from operations over the next five years range between $2.0 million and $2.2 million. Since the majority of our accrued benefit obligations represent our obligation under our non-registered supplementary plan, which is not required to be funded, the recent capital market turmoil is not expected to have a material adverse effect on our cash flow requirements with respect to our pension obligations, or our pension expense.

Future Liquidity and Capital Resources

As discussed in more detail under the heading "Overview – Significant 2012 Events and Developments – 2011/2012 Refinancing Plan", Extendicare has substantially completed the refinancing of approximately US$636 million of its U.S. long-term debt. Management anticipates refinancing this debt with approximately US$510 million of HUD-insured mortgages and US$126 million of cash on hand. As at November 7, 2012, we had closed on all but one, or US$3.9 million, of the HUD loans, which is anticipated to close by the end of the 2013 first quarter. Upon conclusion of the refinancing, EHSI anticipates closing on approximately US$510 million in HUD-insured mortgages with a weighted average all-in rate of approximately 4.26% and term to maturity of about 32 years, which is anticipated to reduce our interest costs by approximately US$20 million per annum. Together with the annual interest savings of approximately $5 million resulting from the December 2011 refinancing of $72.4 million of our Canadian debt, we anticipate total interest savings of approximately $25 million per annum.

As at September 30, 2012, EHSI had cash on hand of US$43.3 million and US$91.0 million available under the EHSI Credit Facility. Our Canadian operations had cash on hand of $128.4 million and available bank lines of $26.9 million at the end of September 2012. In October 2012, we completed the redemption of our 2013 Debentures using cash on hand of $94.0 million. As at September 30, 2012, we had approximately 55 unencumbered centers in the U.S. valued at an estimated US$250 million.

We are currently projected to spend up to approximately $35 million in facility maintenance capital expenditures and approximately $50 million in growth capital expenditures in 2012. As at September 30, 2012, EHSI and ECI had outstanding capital expenditure commitments totalling US$10.1 million and $43.1 million, respectively. ECI's commitments relate to the Timmins and Sault Ste. Marie construction projects.

Management remains confident that cash from operating activities, together with available bank credit facilities, will be sufficient to meet Extendicare's current requirements to support ongoing operations, facility maintenance capital expenditures, and debt repayment obligations. Extendicare's approach to distributing funds available from operations, which remains unchanged following the 2012 Conversion, necessitates raising funds through debt financings and the capital markets to fund strategic acquisitions and growth capital expenditures.

RELATED PARTY TRANSACTIONS

On April 7, 2008, Tim Lukenda, the former President of Tendercare, was appointed President and Chief Executive Officer of Extendicare. Prior to its acquisition by EHSI, Mr. Lukenda owned an approximate 4.6% direct and indirect interest in Tendercare and received, directly or indirectly, on completion of the acquisition of Tendercare an equivalent percentage of the consideration paid by EHSI. EHSI completed the acquisition of Tendercare, a privately owned operator of senior care centers in the State of Michigan, in October 2007 for $225.0 million (US$238.2 million), which was comprised of 29 skilled nursing centers and one inpatient rehabilitation hospital, for a total of 3,301 operational beds. As part of Mr. Lukenda's terms of employment, the employment contract provides a mechanism and process that effectively removes Mr. Lukenda from the decision-making process in situations where a conflict of interest may arise on any matter between Extendicare and his previous employer, or with respect to any financial interest that Mr. Lukenda or his family have with Extendicare and its subsidiaries. As part of the acquisition of Tendercare, in addition to normal representation and warranty provisions, EHSI must agree on any adjustments to the final purchase price, before making any payments to Mr. Lukenda

or his family. EHSI and ECI also provide certain management services to two long-term care centers and operate under lease arrangements two long-term care centers that are owned or partially owned by members of Mr. Lukenda's immediate family.

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

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

OFF-BALANCE SHEET ARRANGEMENTS

Both ALC and EHSI are the lessees under lease agreements with LTC (the "LTC Master Leases"), which cover 37 assisted living properties operated by ALC. LTC declined to remove EHSI as a party to the leases following the distribution of ALC. Therefore, EHSI continues to be bound by the terms of the leases, while only ALC has a financial interest in the leased properties. A separation agreement entered into between Extendicare Inc. and ALC (the "Separation Agreement"), provides EHSI with indemnification against any claims arising as a result of ALC's non-performance relating to the LTC Master Leases. EHSI, being a party to the LTC Master Lease, has to approve any renewal options being exercised.

The LTC Master Leases provide for an initial 10-year term and three successive 10-year lease terms at the option of the lessee. There are no significant economic penalties if the renewal options are not exercised. The aggregate minimum rental payment for the 2012 calendar year is US$11.3 million and will increase by 2% for each of the calendar years through 2014. Annual minimum rent during any renewal term will increase by a minimum of 2% over the minimum rent of the immediately preceding year.

ACCOUNTING POLICIES AND ESTIMATES

Non-GAAP Measures

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

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

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

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

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

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

Critical Accounting Policies and Estimates

A full discussion of Extendicare's critical accounting policies and estimates was provided in the MD&A and the accompanying notes to the audited consolidated financial statements for the year ended December 31, 2011, contained in the REIT's 2011 Annual Report. The disclosures in such report have not materially changed since that report was filed; however, to the extent there have been changes in management's estimates, they are discussed under headings "Overview – Significant 2012 Events and Developments", and "Other Significant Developments".

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

RISKS AND UNCERTAINTIES

There are certain risks inherent in an investment in and in the activities of Extendicare, which investors should carefully consider before investing in Extendicare. Risks and uncertainties are disclosed in Extendicare's latest Annual Information Form and in the REIT's 2011 Annual Report. To the extent there have been any changes to those risks factors or uncertainties as of the date of this MD&A, they are discussed under the headings "Overview – Significant 2012 Events and Developments" and "Other Significant Developments".

Extendicare Inc.

Interim Condensed Consolidated Statements of Financial Position

(unaudited)

(in thousands of Canadian dollars)	*notes*	September 30, 2012	December 31, 2011
Assets			
Current assets			
Cash and short-term investments		**171,439**	80,018
Restricted cash	*7*	**24,096**	16,848
Accounts receivable		**204,464**	222,707
Income taxes recoverable		**5,289**	8,223
Other current assets		**33,272**	32,279
Total current assets		**438,560**	360,075
Non-current assets			
Property and equipment	*5*	**1,157,023**	1,192,913
Goodwill and other intangible assets		**81,875**	87,269
Other assets	*4*	**168,963**	154,695
Deferred tax assets		**23,087**	35,752
Total non-current assets		**1,430,948**	1,470,629
Total Assets	*18*	**1,869,508**	1,830,704
Liabilities and Equity			
Current liabilities			
Accounts payable and accrued liabilities		**236,124**	266,934
Income taxes payable		**13,959**	10,519
Long-term debt	*7*	**121,934**	192,698
Provisions	*6*	**25,429**	24,408
Total current liabilities		**397,446**	494,559
Non-current liabilities			
Long-term debt	*7*	**1,078,721**	941,742
Provisions	*6*	**96,215**	81,120
Other long-term liabilities	*8*	**47,638**	49,638
Deferred tax liabilities		**198,012**	215,326
Total non-current liabilities		**1,420,586**	1,287,826
Total liabilities	*18*	**1,818,032**	1,782,385
Unit capital	*9*	**-**	453,150
Share capital	*9*	**463,900**	-
Equity portion of convertible debentures	*7*	**4,842**	-
Contributed surplus		**48**	81
Accumulated deficit		**(391,628)**	(386,174)
Accumulated other comprehensive loss		**(25,686)**	(18,738)
Shareholders' / Unitholders' equity		**51,476**	48,319
Total Liabilities and Equity		**1,869,508**	1,830,704

See accompaning notes to unaudited condensed consolidated financial statements.

Subsequent events (notes 7, 16 and 19).

Commitments and contingencies (note 15).

Extendicare Inc.
Interim Condensed Consolidated Statements of Earnings
(unaudited)

(in thousands of Canadian dollars)	*notes*	Three months ended September 30 2012	2011	Nine months ended September 30 2012	2011
CONTINUING OPERATIONS					
Revenue					
Nursing and assisted living centers					
United States		**301,366**	342,401	**963,650**	1,016,470
Canada		**139,150**	132,634	**409,621**	389,055
Home health care - Canada		**42,259**	41,723	**126,651**	121,823
Health technology services - United States		**6,107**	4,945	**18,412**	14,154
Outpatient therapy - United States		**3,257**	3,471	**10,454**	10,253
Rent, management, consulting and other services		**6,366**	3,283	**11,591**	10,501
Total revenue	*18*	**498,505**	528,457	**1,540,379**	1,562,256
Operating expenses		**441,987**	471,535	**1,353,098**	1,342,240
Administrative costs		**16,517**	15,449	**48,690**	51,891
Lease costs		**2,696**	2,699	**8,276**	8,092
Total expenses	*10*	**461,200**	489,683	**1,410,064**	1,402,223
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items	*18*	**37,305**	38,774	**130,315**	160,033
Depreciation and amortization		**19,005**	19,096	**57,815**	56,990
Loss from asset impairment, disposals and other items	*11*	**4,847**	54,202	**8,297**	53,829
Results from operating activities		**13,453**	(34,524)	**64,203**	49,214
Interest expense		**15,963**	23,848	**48,768**	69,217
Accretion of decommissioning provisions		**421**	399	**1,276**	1,196
Other accretion		**120**	104	**331**	313
Distributions on Exchangeable LP Units		**-**	649	**-**	1,963
Loss on foreign exchange and financial instruments		**-**	337	**1,103**	-
Finance costs		**16,504**	25,337	**51,478**	72,689
Interest revenue		**531**	1,836	**2,344**	3,666
Fair value adjustments		**2,029**	21,092	**7,136**	17,385
Gains on foreign exchange and financial instruments		**-**	-	**-**	668
Finance income		**2,560**	22,928	**9,480**	21,719
Net finance costs	*12*	**13,944**	2,409	**41,998**	50,970
Earnings (loss) before income taxes		**(491)**	(36,933)	**22,205**	(1,756)
Income tax expense (recovery)					
Current		**2,679**	7,927	**7,578**	28,821
Deferred		**1,912**	(9,177)	**1,558**	(14,523)
Total income tax expense (recovery)		**4,591**	(1,250)	**9,136**	14,298
Earnings (loss) from continuing operations		**(5,082)**	(35,683)	**13,069**	(16,054)
DISCONTINUED OPERATIONS					
Earnings from discontinued operations, net of income taxes	*14*	**431**	1,300	**34,961**	3,555
Net earnings (loss)		**(4,651)**	(34,383)	**48,030**	(12,499)
Attributable to:					
Shareholders of the Company		**(4,651)**	(34,383)	**48,030**	(12,499)
Net earnings (loss)		**(4,651)**	(34,383)	**48,030**	(12,499)
Basic Loss per Share					
Loss from continuing operations	*13*	**(0.06)**		**0.15**	
Net loss	*13*	**(0.05)**		**0.57**	
Diluted Earnings per Share					
Earnings from continuing operations	*13*	**(0.05)**		**0.13**	
Net earnings	*13*	**(0.05)**		**0.48**	

See accompaning notes to unaudited condensed consolidated financial statements.

Extendicare Inc.

Interim Condensed Consolidated Statement of Comprehensive Income (Loss)

(unaudited)

(in thousands of Canadian dollars)	Three months ended September 30		Nine months ended September 30	
	2012	**2011**	**2012**	**2011**
Net earnings (loss)	**(4,651)**	(34,383)	**48,030**	(12,499)
Other comprehensive income (loss), net of income taxes				
Unrealized gain on available-for-sale securities	**1,059**	19	**1,260**	129
Reclassification of realized loss (gain) on available-for-sale securities to earnings	**(80)**	(70)	**272**	(117)
Defined benefit plan actuarial loss, net of tax	**(673)**	(2,607)	**(775)**	(2,775)
Net change in foreign currency translation adjustment	**(9,072)**	20,290	**(7,705)**	11,586
Other comprehensive income (loss), net of tax	**(8,766)**	17,632	**(6,948)**	8,823
Total comprehensive income (loss)	**(13,417)**	(16,751)	**41,082**	(3,676)

See accompaning notes to unaudited condensed consolidated financial statements.

Extendicare Inc.

Interim Condensed Consolidated Statements of Changes in Equity

(unaudited)

		For the nine months ended September 30, 2011						
(amounts in thousands of Canadian dollars)	*notes*	Unit Capital	Share Capital	Equity portion of Covertible Debentures	Contributed Surplus	Deficit	Accumulated OCI (loss)	Total Unitholders' Equity
Balance at January 1, 2011		421,213	-	-	81	(287,525)	(20,775)	112,994
Total comprehensive loss for the period								
Net loss for the period						(12,499)	-	(12,499)
Other comprehensive income								
Foreign currency translation differences for foreign operations							11,586	11,586
Net change in fair value of available-for-sale financial assets, net of tax							129	129
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of tax							(117)	(117)
Defined benefit plan actuarial gains and losses, net of tax							(2,775)	(2,775)
Total other comprehensive income		-	-	-	-	-	8,823	8,823
Total comprehensive loss for the period		-	-	-	-	(12,499)	8,823	(3,676)
Transactions with unitholders, recorded directly in equity								
DRIP		5,860					-	5,860
Conversion from Exchangeable LP Units		308					-	308
Conversion from convertible debentures		8					-	8
Distributions declared						(50,508)	-	(50,508)
Other						(13)	-	(13)
Total transactions with unitholders		6,176	-	-	-	(50,521)	-	(44,345)
Balance at September 30, 2011		427,389	-	-	81	(350,545)	(11,952)	64,973

		For the nine months ended September 30, 2012						
(amounts in thousands of Canadian dollars)		Unit Capital	Share Capital	Equity portion of Covertible Debentures	Contributed Surplus	Deficit	Accumulated OCI (loss)	Total Shareholders' / Unitholders' Equity
Balance at January 1, 2012		**453,150**	-	-	**81**	**(386,174)**	**(18,738)**	**48,319**
2012 Conversion	*1, 9*	**(460,262)**	**460,262**					-
Total comprehensive income for the period								-
Net earnings for the period						**48,030**	-	**48,030**
Other comprehensive income								-
Foreign currency translation differences for foreign operations							**(7,705)**	**(7,705)**
Net change in fair value of available-for-sale financial assets, net of tax							**1,260**	**1,260**
Net change in fair value of available-for-sale financial assets transferred to profit or loss, net of tax							**272**	**272**
Defined benefit plan actuarial losses, net of tax							**(775)**	**(775)**
Total other comprehensive loss		-	-	-	-	-	**(6,948)**	**(6,948)**
Total comprehensive income for the period		-	-	-	-	**48,030**	**(6,948)**	**41,082**
Transactions with shareholders / unitholders, recorded directly in equity								
DRIP		**7,112**	**3,712**				-	**10,824**
Purchase of shares for cancellation in excess of book value		-	**(74)**	-	**(33)**		-	**(107)**
Issuance of convertible debentures				**4,842**				**4,842**
Dividends / distributions declared						**(53,475)**	-	**(53,475)**
Other						**(9)**	-	**(9)**
Total transactions with shareholders / unitholders		**7,112**	**3,638**	**4,842**	**(33)**	**(53,484)**	-	**(37,925)**
Balance at September 30, 2012		-	**463,900**	**4,842**	**48**	**(391,628)**	**(25,686)**	**51,476**

See accompaning notes to unaudited condensed consolidated financial statements.

Extendicare Inc.

Interim Condensed Consolidated Statements of Cash Flows

(unaudited)

	Three months ended September 30		Nine months ended September 30	
(in thousands of Canadian dollars)	**2012**	**2011**	**2012**	**2011**
Operating Activities				
Net earnings (loss)	**(4,651)**	(34,383)	**48,030**	(12,499)
Adjustments for:				
Depreciation and amortization	**19,004**	19,117	**57,814**	57,054
Accrual for self-insured liabilities in provisions	**17,517**	36,364	**34,847**	49,161
Payments for self-insured liabilities in provisions	**(4,450)**	(14,289)	**(17,163)**	(25,993)
Deferred taxes	**2,054**	(9,177)	**1,603**	(14,523)
Current taxes	**2,800**	8,704	**29,025**	31,000
Loss from asset impairment, disposals and other items	**4,847**	54,202	**8,297**	53,829
Gain from asset disposals from discontinued operations	**(694)**	-	**(56,453)**	-
Net finance costs	**13,944**	2,409	**41,998**	50,970
Interest capitalized	**(157)**	(106)	**(347)**	(160)
Other	**(102)**	61	**204**	300
	50,112	62,902	**147,855**	189,139
Net change in operating assets and liabilities				
Accounts receivable	**2,085**	(501)	**17,446**	8,144
Other current assets	**3,996**	(699)	**380**	(6,319)
Accounts payable and accrued liabilities	**(7,981)**	138	**(35,152)**	(15,785)
	48,212	61,840	**130,529**	175,179
Interest paid	**(11,801)**	(17,956)	**(43,277)**	(61,063)
Interest received	**535**	1,824	**2,300**	3,651
Income taxes paid	**(5,802)**	(3,734)	**(22,089)**	(18,727)
Net cash from operating activities	**31,144**	41,974	**67,463**	99,040
Investing Activities				
Purchase of property, equipment and software	**(24,026)**	(18,229)	**(50,380)**	(43,684)
Purchase of nursing center, net of cash acquired	**-**	-	**-**	(7,299)
Net proceeds from dispositions	**-**	-	**56,323**	4,805
Increase of other assets	**(2,170)**	(564)	**(5,809)**	(1,319)
Net cash from investing activities	**(26,196)**	(18,793)	**134**	(47,497)
Financing Activities				
Issue of long-term debt, excluding line of credit	**134,627**	171,410	**292,908**	294,790
Repayment of long-term debt, excluding line of credit	**(16,248)**	(262,166)	**(139,719)**	(323,251)
Issue on line of credit	**(201)**	30,042	**59,125**	40,386
Repayment on line of credit	**359**	(13,615)	**(105,832)**	(27,666)
Increase in restricted cash	**(719)**	(849)	**(7,248)**	(544)
Decrease (increase) in investments held for self-insured liabilities	**(2,798)**	7,442	**(19,324)**	14,104
Dividends / distributions paid	**(14,177)**	(14,313)	**(42,555)**	(44,597)
Financing costs	**(6,218)**	(4,300)	**(11,897)**	(16,423)
Other	**(12)**	31	**(6)**	628
Net cash from financing activities	**94,613**	(86,318)	**25,452**	(62,573)
Increase (decrease) in cash and cash equivalents	**99,561**	(63,137)	**93,049**	(11,030)
Cash and cash equivalents at beginning of period	**73,433**	314,312	**80,018**	267,759
Foreign exchange gain (loss) on cash held in foreign currency	**(1,555)**	14,418	**(1,628)**	8,864
Cash and cash equivalents at end of period	**171,439**	265,593	**171,439**	265,593

See accompaning notes to unaudited condensed consolidated financial statements.

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

Notes to Unaudited Interim Condensed Consolidated Financial Statements

NINE MONTHS ENDED SEPTEMBER 30, 2012 AND 2011

1. GENERAL INFORMATION AND NATURE OF THE BUSINESS

Extendicare Inc. ("Extendicare" or the "Company") is the successor to Extendicare Real Estate Investment Trust ("Extendicare REIT" or the "REIT") following the conversion of the REIT from an income trust to a corporate structure pursuant to a plan of arrangement effective July 1, 2012 (the "2012 Conversion"). The 2012 Conversion was accounted for by the Company as a continuity of interest, and accordingly, the consolidated financial statements of the Company are reflective as if the Company had always carried on the business previously carried on indirectly by Extendicare REIT (*note 9*). Commencing with the three and nine months ended September 30, 2012, comparative information for Extendicare relating to periods prior to the 2012 Conversion is that of its predecessor, Extendicare REIT.

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

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

2. BASIS OF PREPARATION

a) Statement of Compliance

These interim condensed consolidated financial statements have been prepared in accordance with IAS 34 "Interim Financial Reporting", as issued by the International Accounting Standards Board (IASB); and were approved by the board of directors of Extendicare Inc. (the "Board") on November 7, 2012.

These interim condensed consolidated financial statements do not include all of the information required for full annual financial statements, and should be read in conjunction with Extendicare REIT's 2011 annual consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS). Significant accounting policies have not changed since December 31, 2011.

b) Basis of Measurement

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

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

c) Use of Estimates and Judgement

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

The more subjective of such estimates and judgement are:

- revenue recognition;
- valuation of accounts receivable;
- determination of the recoverable amount of cash generating units subject to an impairment test;
- valuation of decommissioning provisions;
- valuation of self-insured liabilities;
- valuation of financial assets and liabilities;
- valuation of share appreciation rights liabilities; and
- accounting for tax uncertainties and the tax rates used for valuation of deferred taxes.

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 listed below detail the policies relating to new transactions that occurred during the 2012 third quarter. For a comprehensive listing of all other significant accounting policies, please refer to *note 3* of Extendicare REIT's 2011 annual consolidated financial statements.

Leases

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

WHEN THE COMPANY IS THE LESSEE

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

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

WHEN THE COMPANY IS THE LESSOR

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

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

4. OTHER ASSETS

	September 30, 2012	December 31, 2011
Investments held for self-insured liabilities - available-for-sale securities, at fair value	**100,877**	83,608
Notes, mortgages and amounts receivable	**50,333**	48,010
Medicare and Medicaid settlement receivables, less allowance of nil for both periods presented	**17,753**	23,077
	168,963	154,695

5. PROPERTY AND EQUIPMENT

	September 30, 2012	December 31, 2011
Land and land improvements	**163,159**	161,375
Buildings	**1,101,404**	1,135,190
Furniture and equipment	**165,076**	160,420
Leasehold improvements	**9,013**	8,975
Construction in progress	**44,607**	18,770
	1,483,259	1,484,730
less: accumulated depreciation	**(326,236)**	(291,817)
	1,157,023	1,192,913

In May 2012, EHSI entered into an agreement to lease all 21 of its Kentucky skilled nursing centers (1,762 beds) to an experienced third-party long-term care operator based in Texas that operates, through its affiliates, in a number of other states. Effective July 1, 2012, EHSI closed on 19 of the centers (1,545 beds), and closed on the remaining two centers effective October 1, 2012. Under the agreement, the operating leases have 10-year terms with two five-year extensions at the option of the operator. In addition, if certain conditions are met, the operator has the option to purchase all of the centers during the initial lease term at agreed upon per bed amounts. As a result of this transaction, EHSI no longer operates skilled nursing centers in Kentucky. The decision to exit the State of Kentucky is consistent with our continuing strategy for achieving ongoing performance improvements that involves the divestiture of operations that impede growth or create undue risk exposure. A pre-tax loss of $3.6 million (US$3.6 million) was recorded in the first nine months of 2012 relating to this Kentucky transaction *(note 11)*.

6. PROVISIONS

	September 30, 2012	December 31, 2011
Accrual for self-insured liabilities	**95,440**	79,423
Decommissioning provisions	**26,204**	26,105
Total provisions	**121,644**	105,528
Less: current portion	**25,429**	24,408
	96,215	81,120

7. LONG-TERM DEBT

	Interest rate	Year of maturity		September 30, 2012		December 31, 2011
EHSI *(payable in US$)*			*US$*	C$	*US$*	C$
HUD mortgages	3.55% - 5.75%	2018 - 2047	*523,453*	**514,659**	*395,339*	402,060
May 2012 CMBS Financing	6.6525%	2012	-	**-**	*109,887*	111,755
Line of credit	variable	2015	*6,400*	**6,292**	*53,000*	53,901
PrivateBank loans	variable	2013	*34,085*	**33,512**	*34,490*	35,076
Finance lease liabilities	5.24% - 8.7141%	2015 - 2020	*15,473*	**15,213**	*14,823*	15,075
Notes payable	0% - 7.5%	2012 - 2014	*8,102*	**7,966**	*9,083*	9,238
			587,513	**577,642**	*616,622*	627,105
Financing costs			*(19,259)*	**(18,936)**	*(15,330)*	(15,591)
			568,254	**558,706**	*601,292*	611,514
Extendicare and Canadian Subsidiaries *(payable in C$)*						
Convertible unsecured subordinated debentures	6.0%	2019		**105,003**		-
Convertible unsecured subordinated debentures	5.7%	2014		**115,012**		116,778
Convertible unsecured subordinated debentures	7.25%	2013		**92,163**		97,531
CMHC mortgages	2.22% - 7.7%	2013 - 2037		**192,114**		166,308
Non-CMHC mortgages	5.75%	2013		**15,627**		15,912
Finance lease liabilities	6.4% - 7.4%	2026 - 2028		**111,424**		114,667
Construction loans	5.558% - 5.637%	2038		**21,980**		18,288
				653,323		529,484
Financing costs				**(11,374)**		(6,558)
				641,949		522,926
Total debt net of financing costs				**1,200,655**		1,134,440
Less: current portion				**121,934**		192,698
				1,078,721		941,742

EHSI Debt

2011/2012 REFINANCING PLAN

EHSI has substantially completed the refinancing of approximately US$636 million of debt with approximately US$510 million of mortgages insured by the U.S. Department of Housing and Urban Development (HUD) and US$126 million of cash on hand. As at September 30, 2012, EHSI had closed on 67 HUD loans totalling US$503.3 million in connection with this refinancing. In October 2012, EHSI closed on one of the remaining two HUD-insured mortgages for US$3.0 million. EHSI anticipates obtaining and closing on the remaining HUD commitment with a principal balance of US$3.9 million by the end of the first quarter of 2013. Upon conclusion of this refinancing, EHSI anticipates that the new HUD-insured mortgages will have a weighted average rate of approximately 4.26%, inclusive of mortgage insurance premium (MIP) fees, and term to maturity of about 32 years.

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

In July 2010, EHSI received approval as a corporate entity to proceed with HUD applications, subject to an overall limit of US$550.0 million, and in December 2011, received approval to increase the financing capacity to an overall limit of US$585.0 million that expires in October 2013. EHSI already had approximately US$27 million of HUD loans issued prior to this refinancing plan. In addition to the US$510 million resulting from this refinancing plan, EHSI is in the process of securing further HUD loans to refinance existing debt that would utilize approximately US$574 million of its US$585.0 million overall limit before it expires in October 2013. As at September 30, 2012, EHSI had approximately 55 unencumbered centers valued at an estimated US$250 million, none of which are part of the additional HUD financings yet to be completed.

In July 2012, EHSI prepaid US$10.3 million of HUD-insured mortgages with a weighted average interest rate including MIP of 5.77% and closed on new HUD-insured mortgages totalling US$11.2 million with a weighted average interest rate

including MIP of 3.55%. EHSI recorded a $0.8 million (US$0.8 million) loss on refinancing and retirement of debt associated with this refinancing (*note 11*).

HUD MORTGAGE LOANS

As at September 30, 2012, EHSI had a total of 75 HUD-insured loans secured by 75 skilled nursing centers and one assisted living facility. These mortgages have an average remaining term of 31.6 years with fixed interest rates ranging from 3.55% to 5.75% and representing a weighted average interest rate of 4.35%. Depending on the mortgage agreement, prepayments are allowed only after 12 months or 24 months from inception of the mortgage, and thereafter subject to prepayment penalties of 9% or 8%, respectively, of the remaining principal balances. The prepayment penalties decrease each subsequent year by 1% until no penalty is required. As at September 30, 2012, US$450.5 million of the mortgages could not be prepaid, and US$72.9 million were subject to prepayment fees ranging from 3% to 9%.

All HUD-insured mortgage loans are non-recourse loans to EHSI. All mortgages are subject to HUD regulatory agreements that require escrow reserve funds to be deposited with the loan servicer for mortgage insurance premiums, property taxes, insurance and for capital replacements expenditures. As at September 30, 2012, EHSI had escrow reserve funds of US$8.2 million with the loan servicer that are reported within other current assets, and replacement reserve funds of US$9.6 million in other non-current assets. In addition, cash for working capital purposes may only be distributed semi-annually to EHSI from the real estate special purpose entities within the HUD mortgage structures. As at September 30, 2012, restricted cash for working capital was US$14.4 million.

CMBS FINANCINGS

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

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

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

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

In August 2011, we defeased US$65.6 million of the March 2012 CMBS Financing followed by a defeasement of the remaining balance of US$21.0 million in December 2011. In August and October 2011, we prepaid US$194.9 million and US$172.4 million, respectively, of the May 2012 CMBS Financing. In February 2012, we prepaid the final US$108.0 million of May 2012 CMBS Financing.

CREDIT FACILITY

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

The EHSI Credit Facility is used to back letters of credit and for general corporate purposes, and requires EHSI to comply with various financial covenants, including fixed charge coverage, debt leverage, and tangible net worth ratios. It contains customary covenants and events of default and is subject to various mandatory prepayment and commitment reductions. If an event of default occurs, the lenders may accelerate the maturity of the loan under the EHSI Credit Facility, charge a

default rate of interest, and/or foreclose on the mortgages and other collateral securing the EHSI Credit Facility. EHSI is permitted to make voluntary prepayments at any time.

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

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

The amount available to be borrowed as of September 30, 2012, was US$100.0 million, of which EHSI had drawn US$6.4 million and issued US$2.6 million under a letter of credit, leaving US$91.0 million available for working capital and corporate purposes. The letter of credit of US$2.6 million is in favour of a state workers' compensation program which renews annually and matures through to June 2013.

PRIVATEBANK LOANS

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

NOTES PAYABLE

Notes payable of US$8.0 million at 7.5% at September 30, 2012, relate to seller notes arising from the 2007 acquisition of Tendercare (Michigan) Inc. (Tendercare) *(note 17).* The balance is payable at US$4.0 million per annum in 2012 and 2013.

SOVEREIGN BANK LOANS

On June 1, 2011, EHSI paid off the remaining balance of its Sovereign Loans of US$43.0 million using borrowings under the EHSI Credit Facility that were subsequently repaid upon closing of the first phase of the HUD loans. The Sovereign Loans were formally secured by first mortgages on 17 skilled nursing centers owned by Tendercare.

Canadian Debt

CONVERTIBLE UNSECURED SUBORDINATED DEBENTURES

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

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

in part from time to time, at a price equal to the principal amount thereof plus accrued and unpaid interest, on a notice of not more than 60 days and not less than 30 days prior.

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

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

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

On October 29, 2012, Extendicare redeemed the outstanding aggregate principal amount of the 2013 Debentures of $91.8 million, and paid all accrued and unpaid interest thereon for a total payment of $94.0 million.

CMHC MORTGAGES

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

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

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

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

CONSTRUCTION LOANS

In October 2011, ECI secured conventional long-term financing on its Timmins and Sault Ste. Marie centers in Ontario. The first two years of the loans are for construction with interest-only payments, following which the loans will be amortized over 25 years. The Timmins and Sault Ste. Marie loans contain fixed rates for the full 27-year term of 5.558% and 5.637%, respectively, with a requirement to maintain a minimum debt service coverage ratio. ECI made the first draw on the Timmins construction loan during the first quarter of 2012.

Other

RBC LINE OF CREDIT AND LETTERS OF CREDIT

Extendicare has a $70.0 million demand credit facility with the Royal Bank of Canada (the "RBC Credit Facility") for its Canadian operations. The RBC Credit Facility is secured by 14 Canadian nursing centers and guaranteed by certain Canadian operating subsidiaries of Extendicare. This credit facility is used to back letters of credit of which there were $43.1 million issued and outstanding as at September 30, 2012, leaving $26.9 million available. The $43.1 million of letters of credit secured $42.7 million of executive pension obligations, and $0.4 million related to construction projects.

In October 2011, Extendicare amended its RBC Credit Facility to reduce the maximum limit for the future transfer and assignment of the existing licensed beds at the current Timmins and Sault Ste. Marie centers upon completion of the new centers. This reduction will occur upon the assignment of the licensed beds of the Sault Ste. Marie and Timmins centers that is anticipated in the first half of 2013 in the amounts of $5.0 million and $2.5 million, respectively.

In addition, Extendicare has a U.S. dollar letter of credit facility with the Royal Bank of Canada to provide for the issuance of a U.S. dollar letter of credit. As at September 30, 2012, a US$10.2 million letter of credit (December 31, 2011 – US$10.2 million) was issued to a third-party insurer of workers' compensation claims of EHSI and was secured by US$10.2 million in cash collateral held by RBC and invested in short-term deposits. As the cash is pledged as collateral against the letter of credit facility, its use is restricted and therefore, it is presented on the statements of financial position as restricted cash within current assets.

RESTRICTED CASH

Restricted cash consists of the US$10.2 million in cash held by RBC as collateral for a letter of credit issued to a third-party insurer in respect of the workers' compensation claims described above and US$14.4 million held pursuant to the HUD regulatory agreements for working capital purposes.

FINANCING COSTS

Below is a summary of the financing costs:

	Interest Rate	Year of maturity		September 30, 2012		December 31, 2011
EHSI *(payable in US$)*			*US$*	C$	*US$*	C$
HUD mortgages	3.55% - 5.75%	2018 - 2047	*16,435*	**16,159**	*14,502*	14,750
May 2012 CMBS Financing	6.6525%	2012	-	**-**	*310*	315
Line of credit	variable	2015	*2,587*	**2,544**	*146*	148
PrivateBank loans	variable	2013	*237*	**233**	*372*	378
			19,259	**18,936**	*15,330*	15,591
Extendicare and Canadian Subsidiaries *(payable in C$)*						
Convertible unsecured subordinated debentures	6.0%	2019		**4,883**		-
CMHC mortgages	2.22% - 7.7%	2013 - 2037		**5,313**		3,879
Non-CMHC mortgages	5.75%	2013		**69**		115
Finance lease obligations	6.4% - 7.4%	2026 - 2028		**442**		482
Construction loans	5.558% - 5.637%	2038		**667**		2,082
				11,374		6,558
Total financing costs				**30,310**		22,149
Less: current portion				**2,704**		1,707
				27,606		20,442

Financing costs are deducted against long-term debt and are amortized using the effective interest rate method over the term of the debt. Financing costs included as part of long-term debt amounted to $30.3 million at September 30, 2012 (December 31, 2011 – $22.1 million). The increase of $8.2 million in 2012 related primarily to the addition of $11.7 million of costs associated with financing of new and refinancing of existing debt, partially offset by amortization charges included in finance costs and changes in foreign exchange.

8. OTHER LONG-TERM LIABILITIES

	September 30, 2012	December 31, 2011
Accrued pension plan obligation	**33,612**	33,020
Deferred compensation	**10,872**	11,635
Share appreciation rights	**284**	1,348
Future lease commitments	**1,686**	1,826
Other	**1,184**	1,809
	47,638	49,638

Share Appreciation Rights Plan

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

A summary of the SARs that have been granted to date by the Board to senior management and the directors as at September 30, 2012, is as follows:

	Nine months ended September 30, 2012		Twelve months ended December 31, 2011	
	Shares / Units	Weighted Average Vesting Price	Units	Weighted Average Vesting Price
Outstanding, beginning of year	**1,462,417**	**$ 9.49**	1,100,667	$ 8.48
Granted	**614,000**	**8.11**	682,000	10.99
Vested	**(389,667)**	**(6.64)**	-	-
Forfeited	**(70,000)**	**(9.47)**	(320,250)	(9.20)
Outstanding, end of period	**1,616,750**	**$ 9.66**	1,462,417	$ 9.49

The vesting price represents the price at which the respective SARs were granted, and equates to the minimum Common Share price at which they can be vested. As at September 30, 2012, 1,616,750 SARs were outstanding, with an average remaining contractual life of 1.5 years (December 31, 2011 – 1.5 years). During the first nine months of 2012, $0.5 million was recognized in net earnings as an increase to the obligation in SARs (first nine months of 2011 – nominal expense). The related liabilities consisted of $0.3 million included as part of other long-term liabilities and $0.1 million included in accounts payable and accrued liabilities as at September 30, 2012 (December 31, 2011 – $1.3 million in other long-term liabilities).

9. SHARE CAPITAL (UNIT CAPITAL PRIOR TO JULY 1, 2012)

2012 Conversion

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

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

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

Authorized Capital

As noted above, the REIT Units were converted to Common Shares on July 1, 2012, as a result of the 2012 Conversion. Extendicare is authorized to issue an unlimited number of Common Shares and that number of preferred shares of Extendicare (Preferred Shares), issuable in series, equal to 50% of the number of Common Shares that are issued and outstanding at the time of the issuance of any series of Preferred Shares, for consideration and on terms and conditions that the Board may determine without the approval of shareholders.

COMMON SHARES

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

PREFERRED SHARES

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

Normal Course Issuer Bid

On July 5, 2012, Extendicare received the approval of the TSX to commence a normal course issuer bid (the "Bid") to purchase for cancellation up to 4.0 million Common Shares, representing approximately 4.8% of the public float on July 1, 2012. The Bid commenced on July 9, 2012, and provides Extendicare with flexibility to repurchase Common Shares for cancellation until July 8, 2013, or on such earlier date as the Bid is complete. In July 2012, Extendicare acquired for cancellation 13,600 Common Shares at a cost of $0.1 million.

	Share Capital		Unit Capital	
	Shares	Amount	Units	Amount
Balance at January 1, 2011	-	$ -	*79,831,466*	$ 421,213
Transactions with unitholders, recorded directly in equity:				
DRIP	-	-	*636,662*	5,860
Conversion from Exchangeable LP Units	-	-	*75,033*	308
Conversion from convertible debentures	-	-	*704*	8
Balance at September 30, 2011	-	$ -	*80,543,865*	$ 427,389
Balance at January 1, 2012	**-**	**$ -**	***84,121,488***	**$ 453,150**
2012 Conversion	***85,028,197***	**460,262**	***(85,028,197)***	**(460,262)**
Transactions with shareholderss / unitholders, recorded directly in equity:				
DRIP	***493,926***	**3,712**	***906,709***	**7,112**
Purchase of shares for cancellation in excess of book value	***(13,600)***	**(74)**	**-**	**-**
Balance at September 30, 2012	***85,508,523***	**$ 463,900**	**-**	**$ -**

10. EXPENSES BY NATURE

	Three months ended September 30		Nine months ended September 30	
	2012	2011	2012	2011
Employee wages and benefits	**335,170**	342,263	**1,035,901**	1,016,142
Food, drugs, supplies and other variable costs	**42,473**	46,079	**136,898**	136,381
Property based and other costs	**80,861**	98,642	**228,989**	241,608
Total operating expenses and administrative costs	**458,504**	486,984	**1,401,788**	1,394,131
Lease costs	**2,696**	2,699	**8,276**	8,092
Total expenses	**461,200**	489,683	**1,410,064**	1,402,223

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

	Three months ended September 30		Nine months ended September 30	
	2012	2011	2012	2011
Loss on Kentucky lease transaction	**1,046**	-	**3,649**	-
Asset impairment	**2,806**	54,012	**2,806**	54,012
Debt settlement	**912**	2,107	**912**	2,676
Gain on disposals	**-**	-	**-**	(494)
Release of provision for contingent liabilities	**-**	(1,917)	**-**	(2,365)
2012 Conversion costs	**83**	-	**930**	-
Loss (gain) from asset impairment, disposals and other items	**4,847**	54,202	**8,297**	53,829

2012

In the second quarter of 2012, EHSI entered into an agreement to lease all 21 of its Kentucky skilled nursing centers to an experienced third-party long-term care operator based in Texas that operates through its affiliates in a number of other states, refer to *note 5*. As a result of this transaction, a pre-tax loss of $1.0 million (US$1.0 million) and $3.6 million (US$3.6 million) was recorded in the three and nine months ended September 30, 2012, respectively.

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

As of September 30, 2012, EHSI has recognized a net pre-tax impairment loss of $0.2 million (US$0.2 million), consisting of a goodwill impairment of $1.1 million (US$1.1 million), a $15.5 million impairment on certain properties and a $16.4 million reversal of a previously recorded impairment loss on property and equipment.

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

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

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

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

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

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

In July 2012, EHSI prepaid US$10.3 million of HUD-insured mortgages with a weighted average interest rate including MIP of 5.77% (*note 7*). EHSI recorded a $0.8 million (US$0.8 million) loss on refinancing and retirement of debt associated with this transaction.

In the three and nine months ended September 30, 2012, Extendicare incurred $0.1 million and 0.9 million, respectively, relating to the 2012 Conversion from an income trust structure to a corporate structure (*notes 1 and 9*).

2011

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

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

Capitalization rates:	
Nursing centers	13.1%
Assisted living centers	9.1%
Maintenance capital expenditure per bed	US$300
Management fee as a % of revenue	5.0%

In August 2011, EHSI prepaid US$194.9 million of the May 2012 CMBS debt and defeased US$65.6 million of the March 2012 CMBS debt, respectively, resulting in a pre-tax loss of $2.1 million (US$2.1 million) on debt settlement that included the defeasance penalty of US$1.4 million, transaction fees of US$0.2 million and the write-off of unamortized loan fees on the debt of US$0.5 million *(note 7)*.

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

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

Extendicare had a provision for contingent liabilities in connection with the sale of its investment in Crown Life. In April 2011, settlement was reached on one of the claims below the amount accrued for that particular item, resulting in the release of $0.4 million of the provision. Another settlement was reached in August 2011 for the remaining claim, resulting in the release of the remainder of the provision of $1.9 million.

12. FINANCE COSTS AND FINANCE INCOME

Convertible Debentures

The fair value adjustment on REIT Issued Convertible Debentures was a gain of $2.0 million for the 2012 third quarter and a gain of $7.1 million for the first nine months of 2012, compared to a gain of $10.6 million and a gain of $10.2 million, respectively, for the same periods in 2011. This related to the remeasurement of the liability at fair value at the end of each period.

Exchangeable LP Units

The Exchangeable LP Units were intended to be economically equivalent to the REIT Units, to the greatest extent practicable. These units were accompanied by special voting units of the REIT that entitled the holder to receive notice of, attend and vote at all meetings of unitholders of the REIT. They were exchangeable on a one-for-one basis for REIT Units at the option of the holder, and all remaining Exchangeable LP Units were automatically exchanged for REIT Units on November 10, 2011.

Each Exchangeable LP Unit entitled the holder to receive distributions from Extendicare LP that were economically equivalent to the distributions made to holders of REIT Units, to the greatest extent practicable. Distributions on Exchangeable LP Units of $0.6 million and $2.0 million were recognized for the three and nine months ended September 30, 2011, respectively, in net earnings as part of finance costs.

These Exchangeable LP Units were designated as financial liabilities valued at FVTPL with changes in fair value recognized in net earnings as part of finance costs. The fair value adjustment on Exchangeable LP Units resulted in a gain of $10.5 million for the 2011 third quarter and a gain of $7.2 million for the first nine months of 2011.

Transactions between Canadian and U.S. Subsidiaries

We recorded no foreign exchange gain or loss in the third quarter and a foreign exchange loss of $1.1 million in the first nine months of 2012, and a loss of $0.3 million and a gain of $0.3 million, respectively, in the same 2011 periods. These resulted primarily from payments of intercompany dividends and the change in value of foreign currency-denominated notes between EHSI and some of the Canadian-based subsidiaries.

Foreign Currency Derivatives

There were no foreign currency forward contracts outstanding during the first nine months of 2012. Extendicare recorded a valuation gain of $0.4 million in the same period in 2011. This related primarily to the revaluation of EHSI contracts that locked in the purchase of Canadian dollars at specified foreign exchange rates for US$4.0 million per month until June 2011

13. EARNINGS PER SHARE

Prior to the 2012 Conversion, the unit capital was considered to be a financial liability although it was presented as equity as it met certain exemptions. Therefore, earnings per unit could not be calculated when the Company was not under a corporate structure. Upon the 2012 Conversion, the Common Shares are accounted for as equity; consequently, earnings per share can be computed.

Earnings per share presented have been calculated as if the 2012 Conversion occurred on January 1, 2012.

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

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

	Three months ended September 30, 2012	Nine months ended September 30, 2012
Numerator for Basic and Diluted Earnings (Loss) per Share		
Earnings (loss) from continuing operations		
Net earnings (loss) for basic earnings per share	**(4,651)**	**48,030**
Less: gain from discontinued operations, net of tax	**431**	**34,961**
Earnings (loss) from continuing operations for basic earnings per share	**(5,082)**	**13,069**
Add: after-tax interest on convertible debt	**2,032**	**6,722**
Add: after-tax gain on fair value adjustment on financial instruments	**(2,029)**	**(7,136)**
Earnings (loss) from continuing operations for diluted earnings per share	**(5,079)**	**12,655**
Net earnings (loss)		
Net earnings (loss) for basic earnings per share	**(4,651)**	**48,030**
Add: after-tax interest on convertible debt	**2,032**	**6,722**
Add: after-tax gain on fair value adjustment on financial instruments	**(2,029)**	**(7,136)**
Net earnings (loss) for diluted earnings per share	**(4,648)**	**47,616**
Denominator for Basic and Diluted Earnings per Share		
Weighted average number of shares for basic earnings per share	**85,260,210**	**84,805,749**
Shares / Units issued if all convertible debt was converted	**14,344,104**	**13,991,129**
Total for diluted earnings per share	**99,604,314**	**98,796,878**
Basic Earnings (Loss) per Share *(in dollars)*		
Earnings (loss) from continuing operations	**(0.06)**	**0.15**
Net earnings (loss)	**(0.05)**	**0.57**
Diluted Earnings (Loss) per Share *(in dollars)*		
Earnings (loss) from continuing operations	**(0.05)**	**0.13**
Net earnings (loss)	**(0.05)**	**0.48**

14. DISCONTINUED OPERATIONS

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

	Three months ended September 30		Nine months ended September 30	
	2012	2011	**2012**	2011
Results from discontinued operations				
Other revenue	**-**	3,206	**-**	8,966
Operating expenses	**-**	1,097	**-**	3,133
Lease costs	**-**	11	**-**	35
Total expenses	**-**	1,108	**-**	3,168
Earnings before depreciation and amortization	**-**	2,098	**-**	5,798
Depreciation and amortization	**-**	22	**-**	65
Unusual gain on asset disposals	**(694)**	-	**(56,453)**	-
Earnings before income taxes	**694**	2,076	**56,453**	5,733
Income tax expense	**263**	776	**21,492**	2,178
Earnings from discontinued operations	**431**	1,300	**34,961**	3,555
Cash flows from discontinued operations				
Net cash from operating activities	**685**	1,758	**685**	3,817
Net cash from investing activities	**-**	(2)	**54,803**	(53)
Net cash from financing activities	**-**	-	**-**	-
Effect on cash flows	**685**	1,756	**55,488**	3,764

In January 2012, EHSI completed the sale of its group purchasing organization (GPO) to Navigator Group Purchasing, a subsidiary of Managed Health Care Associates, Inc. for US$56.0 million and recorded a gain of $55.8 million (US$55.0 million), or $34.5 million after tax (US$34.1 million) in the 2012 first quarter and an additional gain of $0.7 million (US$0.7 million), or $0.4 million after tax (US$0.4 million) was recorded in the 2012 third quarter for a working capital adjustment. GPO's operations have been reclassified as discontinued operations.

15. COMMITMENTS AND CONTINGENCIES

Property and Equipment Commitments

As at September 30, 2012, outstanding capital expenditure commitments for EHSI totalled $10.0 million (US$10.1 million); and those for ECI totalled $43.1 million, relating to two redevelopment projects.

Construction for the two Ontario redevelopment projects totalling 436 beds, at a cost of approximately $80 million, began in the spring of 2011. The new 180-bed nursing center in Timmins and a new 256-bed nursing center in Sault Ste. Marie will replace two owned centers (287 class "C" beds) and one leased center (95 interim beds) in the area upon completion in the first half of 2013.

Legal Proceedings and Regulatory Actions

Extendicare and its subsidiaries are defendants in actions brought against them from time to time in connection with their operations. Recently adopted U.S. health care reform legislation is calling for more government oversight of the long-term care industry and operators are experiencing an increase in government investigations, audits and scrutiny of their operations. It is not possible to predict the ultimate outcome of the various proceedings at this time or to estimate additional costs that may result. However, based on current knowledge, management does not believe that liabilities, if any, arising from pending litigation will have a material adverse effect on the consolidated financial position, or results of operations of Extendicare.

EHSI has received subpoenas from the U.S. Department of Health and Human Services (DHHS), Office of the Inspector General (OIG), relating to the possible submission of claims that may be in violation of the U.S. Social Security Act and to the provision of rehabilitation services. EHSI and its subsidiaries believe that they are in material compliance with the requirements imposed on them by the U.S. Social Security Act, and intend to furnish all requested information and to cooperate with the OIG in its investigation. The DHHS, OIG, CMS and other federal and state enforcement agencies may conduct additional investigations related to our business in the future that may, individually or in the aggregate, have a material adverse effect on the business or financial condition of EHSI.

The provision of health care services is subject to complex laws and regulations at the federal and state government levels, including laws that are intended to prevent health care fraud and abuse. On an ongoing basis, long-term care providers are subject to surveys, inspections, audits and investigations by various government authorities to ensure compliance with applicable laws and licensure requirements. In such circumstances, Extendicare cooperates in responding to information requests and takes the necessary corrective actions and, where appropriate, estimates costs that may result from such investigations, to the extent such costs are predictable or determinable.

ALC Spin-Off

The Extendicare reorganization completed in November 2006 (the "2006 Arrangement") included the distribution of Assisted Living Concepts, Inc. (ALC) to Extendicare's shareholders and a number of pre-2006 Arrangement transactions that included certain agreements entered into between Extendicare, EHSI and ALC.

Both ALC and EHSI are the lessees under lease agreements with LTC Properties, Inc. (LTC) (the "LTC Master Leases"), which cover 37 assisted living properties operated by ALC. LTC declined to remove EHSI as a party to the leases following the distribution of ALC. Therefore, EHSI continues to be bound by the terms of the leases, while only ALC has a financial interest in the leased properties. A separation agreement entered into between Extendicare Inc. and ALC provides EHSI with indemnification against any claims arising as a result of ALC's non-performance relating to the LTC Master Leases. EHSI, being a party to the LTC Master Leases, has to approve any renewal options being exercised. The LTC Master Leases provide for an initial 10-year term and three successive 10-year lease terms at the option of the lessee. There are no significant economic penalties if the renewal options are not exercised. The aggregate minimum rental payment for the 2012 calendar year was US$11.3 and will increase by 2% for each of the calendar years through 2014. Annual minimum rent during any renewal term will increase by a minimum rent of the immediately preceding year.

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

16. FINANCIAL RISK MANAGEMENT

Refinancing Risk

As discussed in the long-term debt note *(note 7)* under the heading "EHSI Debt – 2011/2012 Refinancing Plan", Extendicare has substantially completed refinancing US$636 million of its U.S. long-term debt with approximately US$510 million of HUD-insured mortgages and US$126 million of cash on hand. As at November 7, 2012, EHSI had closed on 68 HUD loans totalling US$506.3 million in connection with this refinancing. In addition, Extendicare has successfully completed, in September and October of 2012, a $126.5 million offering of convertible unsecured debentures due September 30, 2019, of which $94.0 million was used to redeem all of the 2013 Debentures on October 29, 2012. Extendicare believes it has the capability to refinance and redeem the 2014 Debentures. Management continues to monitor the financial markets.

Liquidity Risk

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

Other Risks

Other aspects of Extendicare's financial risk management objectives and policies are consistent with those disclosed in the consolidated financial statements as at and for the year ended December 31, 2011.

17. RELATED PARTY TRANSACTIONS

Transactions with Key Management Personnel

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

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

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

18. SEGMENTED INFORMATION

Extendicare has two reportable operating segments: United States operations and Canadian operations. These operations are managed independently of each other because of their geographic areas and regulatory environments. Each operation retains its own management team and is responsible for compiling its own financial information.

Through its subsidiaries, Extendicare operates long-term care centers in the United States and Canada. Also offered in the United States are medical specialty services, such as post-acute care and rehabilitative therapy services, as well as health technology services, while home health care services are provided in Canada.

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

	Three months ended September 30		Nine months ended September 30	
	2012	**2011**	**2012**	**2011**
Revenue				
United States	**314,562**	352,201	**997,656**	1,045,505
Canada	**183,943**	176,256	**542,723**	516,751
	498,505	528,457	**1,540,379**	1,562,256
Earnings before depreciation, amortization, loss from asset impairment, disposals and other items				
United States	**17,028**	19,803	**77,330**	109,298
Canada	**20,277**	18,971	**52,985**	50,735
	37,305	38,774	**130,315**	160,033

	Sep. 30, 2012	Dec. 31, 2011
Total Assets		
United States	**1,286,978**	1,349,608
Canada	**583,768**	481,272
Eliminations	**(1,238)**	(176)
	1,869,508	1,830,704
Total Liabilties		
United States	**1,035,804**	1,098,640
Canada	**783,466**	683,921
Eliminations	**(1,238)**	(176)
	1,818,032	1,782,385

19. SUBSEQUENT EVENTS

Convertible Debentures

On October 29, 2012, Extendicare redeemed the outstanding aggregate principal amount of the 2013 Debentures of $91.8 million, and paid all accrued and unpaid interest thereon for a total payment of $94.0 million.

EXTENDICARE

Facility Location and Resident Capacity

at September 30, 2012	Nursing Centers		Assisted Living and Retirement Centers		Rehab Hospital / Chronic Care Units		Total	
By State/Province	**Number of Centers**	**Resident Capacity**	**Number of Centers**	**Resident Capacity**	**Number of Centers**	**Resident Capacity**	**Number of Centers**	**Resident Capacity**
United States								
Pennsylvania	24	2,917	6	159	-	-	**30**	**3,076**
Michigan	27	2,816	1	51	1	28	**29**	**2,895**
Wisconsin	27	2,289	3	190	-	-	**30**	**2,479**
Ohio	22	2,259	-	30	-	-	**22**	**2,289**
Indiana	17	1,597	-	35	-	-	**17**	**1,632**
Washington	15	1,572	1	50	-		**16**	**1,622**
Minnesota	8	896	-	-	-	-	**8**	**896**
Idaho	2	177	-	-	-	-	**2**	**177**
Oregon	2	166	-	-	-	-	**2**	**166**
Delaware	1	120	-	-	-	-	**1**	**120**
West Virginia	1	120	-	-	-	-	**1**	**120**
Total United States	**146**	**14,929**	**11**	**515**	**1**	**28**	**158**	**15,472**
Canada								
Ontario	55	7,606	2	313	1	141	**58**	**8,060**
Alberta	14	1,397	1	200	-	-	**15**	**1,597**
Manitoba	6	882	1	48	-	-	**7**	**930**
Saskatchewan	5	654	-	-	-	-	**5**	**654**
Total Canada	**80**	**10,539**	**4**	**561**	**1**	**141**	**85**	**11,241**
TOTAL	**226**	**25,468**	**15**	**1,076**	**2**	**169**	**243**	**26,713**
By Type of Ownership								
United States								
Owned	137	14,011	4	305	1	28	**142**	**14,344**
Leased	5	519	-	-	-	-	**5**	**519**
Managed	4	399	7	210	-	-	**11**	**609**
Total United States	**146**	**14,929**	**11**	**515**	**1**	**28**	**158**	**15,472**
Canada								
Owned	48	6,545	1	200	-	-	**49**	**6,745**
Leased	10	1,250	-	76	-	-	**10**	**1,326**
Managed	22	2,744	3	285	1	141	**26**	**3,170**
Total Canada	**80**	**10,539**	**4**	**561**	**1**	**141**	**85**	**11,241**
TOTAL	**226**	**25,468**	**15**	**1,076**	**2**	**169**	**243**	**26,713**

Securityholder Information

Stock Exchange Listing
Toronto Stock Exchange

Symbols: Common Shares – EXE
2014 Convertible Debt – EXE.DB
2019 Convertible Debt – EXE.DB.B

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Published Information
Extendicare's 2011 Annual Report is available for viewing or printing on its website, in addition to news releases, quarterly reports and other filings with the securities commissions.
Printed copies are available upon request to the Secretary.

Visit Extendicare's website @ www.extendicare.com

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