

Interim Condensed Consolidated Financial Statements of

# **MEDICAL FACILITIES CORPORATION**

For the three and six months ended June 30, 2012  
(Unaudited)  
(In U.S. dollars)

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# MEDICAL FACILITIES CORPORATION

Interim Consolidated Balance Sheets  
(In thousands of U.S. dollars)

|   | Note | June 30,<br>2012<br>\$<br>(unaudited) | December 31,<br>2011<br>\$ |
|---|------|---------------------------------------|----------------------------|
| <b>ASSETS</b>   |      |                                       |                            |
| <b>Current assets</b>                                   |      |                                       |                            |
| Cash and cash equivalents                               |      | 22,746                                | 17,984                     |
| Short-term bank deposits                                |      | 12,579                                | 9,034                      |
| Accounts receivable                                     |      | 38,347                                | 41,508                     |
| Supply inventory  |      | 3,849                                 | 3,774                      |
| Prepaid expenses and other                              |      | 3,436                                 | 2,602                      |
| Income tax receivable                                   |      | 7,229                                 | 10,134                     |
| <b>Total current assets</b>                             |      | <b>88,186</b>                         | <b>85,036</b>              |
| <b>Non-current assets</b>                               |      |                                       |                            |
| Long-term bank deposits                                 |      | -                                     | 2,526                      |
| Restricted cash   |      | -                                     | 4,483                      |
| Foreign exchange forward contracts                      |      | 1,053                                 | 3,076                      |
| Deferred income tax assets                              | 10   | 15,242                                | 13,204                     |
| Investment in and loan receivable from an associate     |      | 324                                   | 356                        |
| Property and equipment                                  |      | 55,757                                | 54,808                     |
| Goodwill  |      | 87,278                                | 87,278                     |
| Other intangibles                                       |      | 77,253                                | 83,574                     |
| <b>Total non-current assets</b>                         |      | <b>236,907</b>                        | <b>249,305</b>             |
| <b>TOTAL ASSETS</b>                                     |      | <b>325,093</b>                        | <b>334,341</b>             |
| <b>LIABILITIES AND EQUITY</b>                           |      |                                       |                            |
| <b>Current liabilities</b>                              |      |                                       |                            |
| Interest payable  |      | 529                                   | 526                        |
| Dividends payable                                       |      | 2,555                                 | 2,553                      |
| Accounts payable  |      | 4,929                                 | 7,299                      |
| Accrued liabilities                                     |      | 11,400                                | 12,602                     |
| Current portion of long-term debt                       | 5    | 16,756                                | 11,889                     |
| Convertible secured debentures                          | 4    | 43,703                                | -                          |
| <b>Total current liabilities</b>                        |      | <b>79,872</b>                         | <b>34,869</b>              |
| <b>Non-current liabilities</b>                          |      |                                       |                            |
| Long-term debt  | 5    | 25,197                                | 32,083                     |
| Foreign exchange forward contracts                      |      | 488                                   | 424                        |
| Convertible secured debentures                          | 4    | -                                     | 43,110                     |
| Exchangeable interest liability                         |      | 76,789                                | 72,031                     |
| <b>Total non-current liabilities</b>                    |      | <b>102,474</b>                        | <b>147,648</b>             |
| <b>Total liabilities</b>                                |      | <b>182,346</b>                        | <b>182,517</b>             |
| <b>Equity</b>   |      |                                       |                            |
| Share capital   | 6    | 362,409                               | 361,935                    |
| Deficit   |      | (237,833)                             | (228,352)                  |
| <b>Equity attributable to owners of the Corporation</b> |      | <b>124,576</b>                        | <b>133,583</b>             |
| <b>Non-controlling interest</b>                         |      | <b>18,171</b>                         | <b>18,241</b>              |
| <b>Total equity</b>                                     |      | <b>142,747</b>                        | <b>151,824</b>             |
| Commitments and contingencies                           | 13   |                                       |                            |
| <b>TOTAL LIABILITIES AND EQUITY</b>                     |      | <b>325,093</b>                        | <b>334,341</b>             |

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Interim Consolidated Statements of Changes in Equity  
(In thousands of U.S. dollars)  
(Unaudited)

|   |      | Attributable to Owners of the Corporation |                  |                | Non-controlling Interest | Total Equity   |
|---|------|---|------------------|----------------|--------------------------|----------------|
|   | Note | Share Capital<br>\$                       | Deficit<br>\$    | Total<br>\$    | \$                       | \$             |
| <b>2012</b>   |      |   |                  |                |                          |                |
| Balance at December 31, 2011  |      | 361,935                                   | (228,352)        | 133,583        | 18,241                   | 151,824        |
| Net income and comprehensive income                                       |      | -   | 6,035            | 6,035          | 14,566                   | 20,601         |
| Dividends to owners of the Corporation                                    |      | -   | (15,516)         | (15,516)       | -                        | (15,516)       |
| Distributions to non-controlling interest                                 |      | -   | -                | -              | (14,636)                 | (14,636)       |
| Acquisition of additional interest in OSH                                 | 3    | 722                                       | -                | 722            | -                        | 722            |
| Conversion of convertible secured debentures into common shares           | 4    | 15  | -                | 15             | -                        | 15             |
| Purchase of common shares under the terms of normal courser issuer bid    | 7    | (263)                                     | -                | (263)          | -                        | (263)          |
| <b>Balance at June 30, 2012</b>   |      | <b>362,409</b>                            | <b>(237,833)</b> | <b>124,576</b> | <b>18,171</b>            | <b>142,747</b> |
| <b>2011</b>   |      |   |                  |                |                          |                |
| Balance at December 31, 2010  |      | 98,764                                    | (76,937)         | 21,827         | 21,551                   | 43,378         |
| Net income (loss) and comprehensive income (loss)                         |      | -   | (32,212)         | (32,212)       | 13,088                   | (19,124)       |
| Dividends to owners of the Corporation                                    |      | -   | (7,052)          | (7,052)        | -                        | (7,052)        |
| Distributions to non-controlling interest                                 |      | -   | -                | -              | (15,454)                 | (15,454)       |
| Acquisition of additional interests in OSH                                | 3    | 1,458                                     | -                | 1,458          | -                        | 1,458          |
| Elimination of common share component of previously outstanding IPS units | 6    | (99,132)                                  | -                | (99,132)       | -                        | (99,132)       |
| Issue of common shares on exchange of previously outstanding IPS units    | 6    | 362,403                                   | (113,350)        | 249,053        | -                        | 249,053        |
| Purchase of IPS units under the terms of normal course issuer bid         | 7    | (82)                                      | -                | (82)           | -                        | (82)           |
| <b>Balance at June 30, 2011</b>   |      | <b>363,411</b>                            | <b>(229,551)</b> | <b>133,860</b> | <b>19,185</b>            | <b>153,045</b> |

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Interim Consolidated Statements of Comprehensive Income  
(In thousands of U.S. dollars, except per share amounts)  
(Unaudited)

|  | Note | Three Months Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                 |
|--|------|--------------------------------|-----------------|------------------------------|-----------------|
|  |      | 2012<br>\$                     | 2011<br>\$      | 2012<br>\$                   | 2011<br>\$      |
| <b>Facility service revenue</b>  |      | <b>55,077</b>                  | <b>54,338</b>   | <b>115,053</b>               | <b>106,050</b>  |
| <b>Operating expenses</b>  |      |                                |                 |                              |                 |
| Salaries and benefits  |      | 14,080                         | 12,688          | 28,002                       | 25,671          |
| Drugs and supplies   |      | 13,539                         | 13,031          | 27,681                       | 25,409          |
| General and administrative   |      | 8,270                          | 7,178           | 16,530                       | 15,356          |
|  |      | <b>35,889</b>                  | <b>32,897</b>   | <b>72,213</b>                | <b>66,436</b>   |
| <b>Income from operations</b>  |      | <b>19,188</b>                  | <b>21,441</b>   | <b>42,840</b>                | <b>39,614</b>   |
| <b>Depreciation and amortization</b>   |      | <b>4,801</b>                   | <b>4,862</b>    | <b>9,757</b>                 | <b>9,756</b>    |
| <b>Finance costs</b>   |      |                                |                 |                              |                 |
| Interest expense, net of interest income   | 8    | 1,295                          | 5,101           | 2,567                        | 11,908          |
| Interest expense on exchangeable interest liability                                      |      | 2,126                          | 1,890           | 4,144                        | 4,050           |
| Increase in value of subordinated notes payable early redemption option                  |      | -                              | 981             | -                            | 1,185           |
| Loss (gain) on foreign currency  | 9    | 1,549                          | (591)           | (119)                        | 284             |
|  |      | <b>4,970</b>                   | <b>7,381</b>    | <b>6,592</b>                 | <b>17,427</b>   |
| <b>Income before undernoted</b>  |      | <b>9,417</b>                   | <b>9,198</b>    | <b>26,491</b>                | <b>12,431</b>   |
| Increase (decrease) in value of convertible secured debentures                           | 4    | (709)                          | (308)           | 608                          | 1,304           |
| Increase (decrease) in value of exchangeable interest liability                          |      | 2,403                          | (3,877)         | 5,480                        | 14,715          |
| Direct expenses attributable to restructuring  |      | -                              | 468             | -                            | 468             |
| <b>Income (loss) before income taxes</b>   |      | <b>7,723</b>                   | <b>12,915</b>   | <b>20,403</b>                | <b>(4,056)</b>  |
| Income tax expense (recovery)  | 10   | (712)                          | 23,008          | (198)                        | 15,068          |
| <b>Net income (loss) and comprehensive income (loss) for the period</b>                  |      | <b>8,435</b>                   | <b>(10,093)</b> | <b>20,601</b>                | <b>(19,124)</b> |
| <b>Attributable to:</b>  |      |                                |                 |                              |                 |
| Owners of the Corporation  |      | 1,875                          | (17,043)        | 6,035                        | (32,212)        |
| Non-controlling interest   |      | 6,560                          | 6,950           | 14,566                       | 13,088          |
|  |      | <b>8,435</b>                   | <b>(10,093)</b> | <b>20,601</b>                | <b>(19,124)</b> |
| <b>Basic earnings (loss) per share attributable to owners of the Corporation</b>         | 11   | <b>0.066</b>                   | <b>(0.600)</b>  | <b>0.213</b>                 | <b>(1.136)</b>  |
| <b>Fully diluted earnings (loss) per share attributable to owners of the Corporation</b> | 11   | <b>0.062</b>                   | <b>(0.600)</b>  | <b>0.213</b>                 | <b>(1.136)</b>  |

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Interim Consolidated Statements of Cash Flows  
(In thousands of U.S. dollars)  
(Unaudited)

|  |      | Six Months Ended<br>June 30, |                 |
|--|------|------------------------------|-----------------|
|  | Note | 2012<br>\$                   | 2011<br>\$      |
| <b>Cash flows from operating activities</b>  |      |                              |                 |
| Net income (loss) and comprehensive income (loss) for the period                       |      | 20,601                       | (19,124)        |
| Adjustments for:   |      |                              |                 |
| Depreciation of property and equipment   |      | 3,436                        | 3,469           |
| Amortization of other intangibles  |      | 6,321                        | 6,287           |
| Share of equity loss in an associate   |      | 4                            | 4               |
| Increase in value of convertible secured debentures                                    | 4    | 608                          | 1,304           |
| Increase in value of subordinated notes payable early redemption option                |      | -                            | 1,185           |
| Increase in value of exchangeable interest liability                                   |      | 5,480                        | 14,715          |
| Interest expense, net of interest income   | 8    | 2,567                        | 11,908          |
| Loss (gain) on foreign currency  | 9    | (119)                        | 284             |
| Deferred income tax expense (recovery)   | 10   | (2,038)                      | 14,531          |
| Current income tax expense   | 10   | 1,840                        | 537             |
| Interest paid  |      | (954)                        | (13,385)        |
| Income and withholding taxes refunded, net   |      | 1,066                        | 3,213           |
| Change in non-cash operating working capital   |      | (3,048)                      | 2,142           |
| <b>Net cash provided by operating activities</b>                                       |      | <b>35,764</b>                | <b>27,070</b>   |
| <b>Cash flows from investing activities</b>  |      |                              |                 |
| Purchase of property and equipment   |      | (4,385)                      | (1,740)         |
| Redemption of (investment in) short-term bank deposits                                 |      | (3,545)                      | 3,760           |
| Redemption of (investment in) long-term bank deposits                                  |      | 2,526                        | (4,205)         |
| Release of collateral on foreign exchange forward contracts                            |      | 4,483                        | -               |
| Cash interest received   |      | 116                          | 122             |
| <b>Net cash used in investing activities</b>   |      | <b>(805)</b>                 | <b>(2,063)</b>  |
| <b>Cash flows from financing activities</b>  |      |                              |                 |
| Repayments of revolving credit facilities at the Centers                               |      | (442)                        | (2,320)         |
| Repayments of notes payable and obligations under lease arrangements at the Centers    |      | (1,577)                      | (1,532)         |
| Distributions received from an associate   |      | 29                           | -               |
| Distributions to non-controlling interest  |      | (14,636)                     | (15,454)        |
| Dividends paid   |      | (15,514)                     | (5,196)         |
| Purchase of convertible secured debentures under the terms of normal course issuer bid | 4    | -                            | (3)             |
| Purchase of common shares/IPS units under the terms of normal course issuer bids       | 7    | (263)                        | (158)           |
| Costs related to the Conversion  |      | -                            | (1,067)         |
| <b>Net cash used in financing activities</b>   |      | <b>(32,403)</b>              | <b>(25,730)</b> |
| <b>Increase (decrease) in cash and cash equivalents</b>                                |      |                              |                 |
| Effect of exchange rate fluctuations on cash balances held                             |      | 2,206                        | 670             |
| Cash and cash equivalents, beginning of the period                                     |      | 17,984                       | 19,062          |
| <b>Cash and cash equivalents, end of the period</b>                                    |      | <b>22,746</b>                | <b>19,009</b>   |
| Non-cash transactions:   |      |                              |                 |
| Acquisition of additional interests in Oklahoma Spine Hospital, LLC                    | 3    | 722                          | 1,853           |
| Conversion   | 6    | -                            | 362,403         |

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
For the three and six months ended June 30, 2012  
(Unaudited)

## 1. REPORTING ENTITY

Medical Facilities Corporation (the "Company"), is a British Columbia corporation and a public company listed on the Toronto Stock Exchange under the ticker symbol DR. The Company owns indirect controlling interests in five limited liability entities (the "Centers" and collectively with the Company, the "Corporation"), each of which owns a specialty hospital or an ambulatory surgery center located in the United States. The Centers, their locations and the Corporation's ownership interest in each are as follows:

| Centers  | Location                  | Ownership Interest<br>June 30, |       |
|--|---------------------------|--------------------------------|-------|
|  |                           | 2012                           | 2011  |
| Black Hills Surgical Hospital, LLP ("BHSH")                | Rapid City, South Dakota  | 54.2%                          | 54.2% |
| Sioux Falls Specialty Hospital, LLP ("SFSH")               | Sioux Falls, South Dakota | 51.0%                          | 51.0% |
| Dakota Plains Surgical Center, LLP ("DPSC")                | Aberdeen, South Dakota    | 64.6%                          | 64.6% |
| Oklahoma Spine Hospital, LLC ("OSH")                       | Oklahoma City, Oklahoma   | 58.5%                          | 57.8% |
| The Surgery Center of Newport Coast, LLC ("Newport Coast") | Newport Beach, California | 51.0%                          | 51.0% |

On May 31, 2011, the Corporation converted from an income participating securities ("IPS") structure to a traditional common share structure (the "Conversion").

## 2. BASIS OF PREPARATION

### 2.1 Statement of compliance

These unaudited interim condensed consolidated financial statements have been prepared in accordance with IAS 34, *Interim Financial Reporting* issued by the International Accounting Standards Board and follow the same accounting policies and methods of computation as used in the Corporation's audited consolidated financial statements for the year ended December 31, 2011. These unaudited interim condensed consolidated financial statements should be read in conjunction with the Corporation's audited consolidated financial statements for the year ended December 31, 2011.

These interim condensed consolidated financial statements were approved by the Corporation's board of directors on August 13, 2012.

### 2.2 Basis of measurement

These interim condensed consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, which are measured at fair value.

### 2.3 Functional and presentation currency

The Corporation's financial statements are reported in U.S. dollars which is its functional and presentation currency. All financial information presented in U.S. dollars has been rounded to the nearest thousand, unless otherwise indicated.

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

For the three and six months ended June 30, 2012

(Unaudited)

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## 2. BASIS OF PREPARATION (Continued)

The Corporation translates monetary assets and liabilities denominated in Canadian dollars, principally certain of its cash and cash deposit balances, its convertible secured debentures, and, prior to the Conversion, its subordinated notes payable, which are all denominated in Canadian dollars, at exchange rates in effect at the reporting date. Non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations were incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses, including translation adjustments, are included in finance costs in the determination of net income and comprehensive income.

### 2.4 Use of judgments and estimates

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies, reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. On an ongoing basis, management evaluates its judgments and estimates in relation to assets, liabilities, facility service revenue and expenses. Management uses historical experience and various other factors it believes to be reasonable under the circumstances as the basis for its judgments and estimates. Actual results may differ from these estimates.

Management's judgment is required in respect of (i) consolidation, (ii) functional currency, (iii) recognition of deferred tax assets and liabilities and (iv) classification of leases.

Management's estimates are required with respect to (i) facility service revenue and accounts receivable, (ii) supply inventory, (iii) valuation of financial instruments, (iv) acquired assets and liabilities, primarily goodwill and other intangibles, (v) impairment of goodwill and other intangibles, (vi) provision for potential liabilities and (vii) income tax provisions.

## 3. ACQUISITION OF ADDITIONAL INTERESTS IN OSH

In April 2011, pursuant to the terms of the exchange agreement between the Corporation and the holders of the non-controlling interest in OSH ("non-controlling owners"), the non-controlling owners exchanged 0.75% of the ownership in the Center for IPS units of the Corporation which were valued at \$845 (Cdn\$813) based on the market value of the IPS units on the date of the transaction. This consideration was allocated between subordinated notes payable (\$395) and share capital (\$450).

In June 2011, the non-controlling owners of OSH exchanged a further 0.88% of the ownership of the Center for common shares of the Corporation which were valued at \$1,008 (Cdn\$980) based on the market value of the common shares on the date of the transaction. This consideration was allocated to the share capital of the Corporation.



# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

For the three and six months ended June 30, 2012

(Unaudited)

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## 3. ACQUISITION OF ADDITIONAL INTERESTS IN OSH (Continued)

In April 2012, the non-controlling owners exchanged 0.75% of the ownership in the Center for common shares of the Corporation which were valued at \$722 (Cdn\$716) based on the market value of the common shares on the date of the transaction. This consideration was allocated to the share capital of the Corporation.

## 4. CONVERTIBLE SECURED DEBENTURES

The convertible secured debentures are hybrid financial instruments and the Corporation accounts for them under International Financial Reporting Standards ("IFRS") as a single financial liability, including the host instrument and the conversion feature, measured at fair value through profit or loss with unrealized gains or losses recorded in net income and comprehensive income.

The following table represents changes in the convertible secured debentures:

|  | \$            |
|--|---------------|
| Balance at December 31, 2010   | 45,376        |
| Convertible secured debentures purchased and cancelled under the terms of normal course issuer bid | (3)           |
| Decrease in fair value of convertible secured debentures at market price                           | (2,263)       |
| <b>Balance at December 31, 2011</b>  | <b>43,110</b> |
| Balance at December 31, 2011   | 43,110        |
| Increase in fair value of convertible secured debentures at market price                           | 608           |
| Conversion of convertible secured debentures into common shares                                    | (15)          |
| <b>Balance at June 30, 2012</b>  | <b>43,703</b> |

The convertible secured debentures will mature on April 30, 2013. Under the terms of the Trust Indenture, the holders of the convertible secured debentures have the right to convert their holdings into common shares when the price of common shares exceeds \$13.10 per share. If the holders of the convertible secured debentures do not exercise their right to convert their holdings into the Corporation's common shares prior to the maturity date, the principal amount is due and payable in full on maturity. Management of the Corporation is currently evaluating the options for the repayment of the convertible secured debentures not converted prior to their maturity date.

In the previously reported IFRS interim financial statements for the period ended June 30, 2011, these convertible secured debentures were accounted for as compound financial instruments. The debt component was measured at amortized cost using the effective interest rate method, while the equity component was measured at the issue date using the residual method with no future changes in value recognized. Upon Conversion, the instrument was remeasured at fair value and the difference between the amortized cost and fair value was recorded in net income and comprehensive income.

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
For the three and six months ended June 30, 2012  
(Unaudited)

## 4. CONVERTIBLE SECURED DEBENTURES (Continued)

Because of the correction in accounting treatment after publishing the interim condensed consolidated financial statements for the quarterly periods in 2011, the Corporation has made immaterial corrections to the previously reported statement of comprehensive income for the three and six months ended June 30, 2011. For the three months ended June 30, 2011, changes were made to the value of the convertible secured debentures (a decrease of \$4,657), interest expense (a decrease of \$87) and income tax expense (an increase of \$4,608), which resulted in a total decrease to net income and comprehensive income of \$136. For the six months ended June 30, 2011, changes were made to the value of the convertible secured debentures (a decrease of \$4,158), interest expense (a decrease of \$214) and income tax expense (an increase of \$4,475), which resulted in a total decrease to net income and comprehensive income of \$103.

## 5. LONG-TERM DEBT

SFSH was not in compliance with one of the provisions related to its revolving line of credit as of June 30, 2012. The amount outstanding under this line of credit as of June 30, 2012 was \$3,388. The Center received a waiver for non-compliance with this provision from the creditor.

## 6. SHARE CAPITAL

The following table represents changes in the number and value of common shares issued and outstanding for the reporting periods:

|  | Number of<br>Common Shares | \$             |
|--|----------------------------|----------------|
| Opening balance at December 31, 2010   | 28,316,749                 | 98,764         |
| Common shares issued for acquisition of additional interest in OSH in April 2011 (note 3)  | 64,501                     | 450            |
| IPS units purchased and cancelled under the terms of normal course issuer bid (note 7)     | (12,600)                   | (82)           |
| Balance at May 31, 2011  | 28,368,650                 | 99,132         |
| Retirement of common shares on Conversion  | (28,368,650)               | (99,132)       |
| New common shares issued on Conversion   | 28,368,650                 | 362,403        |
| Common shares issued for acquisition of additional interest in OSH in June 2011 (note 3)   | 77,692                     | 1,008          |
| Common shares purchased and cancelled under the terms of normal course issuer bid          | (136,300)                  | (1,476)        |
| <b>Balance at December 31, 2011</b>  | <b>28,310,042</b>          | <b>361,935</b> |
| Opening balance at December 31, 2011   | 28,310,042                 | 361,935        |
| Common shares issued for acquisition of additional interest in OSH in April 2012 (note 3)  | 56,836                     | 722            |
| Common shares issued on exchange of convertible secured debentures (note 4)                | 1,145                      | 15             |
| Common shares purchased and cancelled under the terms of normal course issuer bid (note 7) | (20,058)                   | (263)          |
| <b>Balance at June 30, 2012</b>  | <b>28,347,965</b>          | <b>362,409</b> |

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

For the three and six months ended June 30, 2012

(Unaudited)

## 7. NORMAL COURSE ISSUER BIDS

Pursuant to the normal course issuer bid terminated on May 3, 2012, the Corporation purchased 12,600 of its IPS units during the three-month period ended June 30, 2011 for a total consideration of \$158, allocated between subordinated notes payable (\$76) and share capital (\$82).

Pursuant to the normal course issuer bid in effect from May 15, 2012 to May 14, 2013, the Corporation purchased 20,058 of its common shares during the three-month period ended June 30, 2012 for a total consideration of \$263, recorded in share capital.

All IPS units and common shares acquired under these bids were cancelled.

## 8. INTEREST EXPENSE, NET OF INTEREST INCOME

Interest expense, net of interest income, included in finance costs in the statement of comprehensive income consists of the following:

|  | Three Months Ended<br>June 30, |              | Six Months Ended<br>June 30, |               |
|--|--------------------------------|--------------|------------------------------|---------------|
|  | 2012<br>\$                     | 2011<br>\$   | 2012<br>\$                   | 2011<br>\$    |
| Interest expense at Centers' level                     | 464                            | 549          | 941                          | 1,121         |
| Interest expense on subordinated notes payable         | -                              | 3,710        | -                            | 9,136         |
| Interest expense on convertible secured debentures     | 796                            | 831          | 1,593                        | 1,637         |
| Miscellaneous interest expense at corporate level      | -                              | 2            | -                            | 2             |
| Amortization of available line of credit stand-by fees | 94                             | 70           | 150                          | 134           |
| Interest income  | (59)                           | (61)         | (117)                        | (122)         |
| <b>Interest expense, net of interest income</b>        | <b>1,295</b>                   | <b>5,101</b> | <b>2,567</b>                 | <b>11,908</b> |

## 9. LOSS (GAIN) ON FOREIGN CURRENCY

Loss (gain) on foreign currency included in finance costs in the statement of comprehensive income consists of the following:

|  | Three Months Ended<br>June 30, |              | Six Months Ended<br>June 30, |            |
|--|--------------------------------|--------------|------------------------------|------------|
|  | 2012<br>\$                     | 2011<br>\$   | 2012<br>\$                   | 2011<br>\$ |
| Unrealized loss (gain) on subordinated notes payable   | -                              | 175          | -                            | 4,506      |
| Unrealized loss (gain) on foreign exchange forward contracts                                   | 2,813                          | (214)        | 2,087                        | (3,552)    |
| Unrealized loss (gain) on foreign currency   | 2,813                          | (39)         | 2,087                        | 954        |
| Realized loss (gain) on foreign exchange forward contracts which matured in the current period | (1,520)                        | (565)        | (2,279)                      | (480)      |
| Translation loss (gain) on cash balances denominated in Cdn\$                                  | 256                            | 13           | 73                           | (190)      |
| <b>Loss (gain) on foreign currency</b>   | <b>1,549</b>                   | <b>(591)</b> | <b>(119)</b>                 | <b>284</b> |

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

For the three and six months ended June 30, 2012

(Unaudited)

## 10. INCOME TAXES

The deferred income tax assets included in the balance sheet represent the following:

|   | June 30,<br>2012<br>\$ | December 31,<br>2011<br>\$ |
|---|------------------------|----------------------------|
| Deferred income tax assets related to U.S. tax entity     | 10,517                 | 8,479                      |
| Deferred income tax assets related to Canadian tax entity | 4,725                  | 4,725                      |
| <b>Deferred income tax assets</b>                         | <b>15,242</b>          | <b>13,204</b>              |

The following table summarizes the allocation of the income tax expense (recovery) as presented in the statement of comprehensive income between the current and deferred tax components:

|  | Three Months Ended<br>June 30, |               | Six Months Ended<br>June 30, |               |
|--|--------------------------------|---------------|------------------------------|---------------|
|  | 2012<br>\$                     | 2011<br>\$    | 2012<br>\$                   | 2011<br>\$    |
| Current income tax expense             | 530                            | 537           | 1,840                        | 537           |
| Deferred income tax expense (recovery) | (1,242)                        | 22,471        | (2,038)                      | 14,531        |
| <b>Income tax expense (recovery)</b>   | <b>(712)</b>                   | <b>23,008</b> | <b>(198)</b>                 | <b>15,068</b> |

## 11. EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share attributable to owners of the Corporation are calculated as follows:

|   | Three Months Ended<br>June 30, |                | Six Months Ended<br>June 30, |                |
|---|--------------------------------|----------------|------------------------------|----------------|
|   | 2012<br>\$                     | 2011<br>\$     | 2012<br>\$                   | 2011<br>\$     |
| Net income and comprehensive income (loss) for the period attributable to owners of the Corporation | 1,875                          | (17,043)       | 6,035                        | (32,212)       |
| Divided by weighted average number of common shares outstanding for the period                      | 28,367,401                     | 28,398,819     | 28,337,670                   | 28,358,010     |
| <b>Basic earnings (loss) per share attributable to owners of the Corporation</b>                    | <b>0.066</b>                   | <b>(0.600)</b> | <b>0.213</b>                 | <b>(1.136)</b> |

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

For the three and six months ended June 30, 2012

(Unaudited)

## 11. EARNINGS (LOSS) PER SHARE (Continued)

For the three months ended June 30, 2012, fully diluted earnings per share are calculated as follows:

|   | Three Months<br>Ended<br>June 30, |
|---|-----------------------------------|
|   | 2012                              |
|   | \$                                |
| Net income and comprehensive income for the period attributable to owners of the Corporation                    | 1,875                             |
| Change in value of convertible secured debentures   | (709)                             |
| Interest expense on convertible secured debentures  | 796                               |
| Modified net income and comprehensive income for the period attributable to owners of the Corporation           | 1,962                             |
| Divided by:   |                                   |
| Actual weighted average number of common shares outstanding for the period                                      | 28,367,401                        |
| Number of common shares deemed to be issued on the conversion of the outstanding convertible secured debentures | 3,279,696                         |
| Weighted average number of common shares  | 31,647,097                        |
| <b>Fully diluted earnings per share</b>   | <b>0.062</b>                      |

For the six-month period ended June 30, 2012 and for the three- and six-month periods ended June 30, 2011, issuance of common shares upon exchange of the outstanding exchangeable interest liability and conversion of the outstanding convertible secured debentures would have been anti-dilutive and, therefore, the calculation of fully diluted loss per share is not presented.

## 12. RELATED PARTY TRANSACTIONS AND BALANCES

The Corporation and the Centers routinely enter into transactions with certain related parties. These parties are considered related through ownership in them by the holders of non-controlling interests in the respective Centers. Such transactions are in the normal course of operations and are at fair value agreed upon by the parties involved.

The expenses (primarily general and administrative) resulting from the Corporation's and Centers' transactions with related parties for the three and six months ended June 30, 2012 were \$2,626 and \$5,510, respectively, and for the three and six months ended June 30, 2011 were \$2,684 and \$5,484, respectively.

The amounts payable to the related parties, included in accounts payable, as of June 30, 2012 were \$297 and as of December 31, 2011 were \$1,067.

### 12.1 Other transactions

Certain of the physicians, who indirectly own the non-controlling interest in each of the Centers, routinely provide professional services directly to patients utilizing the facilities of the Centers and reimburse the Centers for the space and staff utilized. Also, certain of the physicians serve on the boards of management of the Centers and three such individuals perform the duties of Medical Director at the respective Centers and are compensated in recognition of their contribution to the Centers.

# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements

(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)

For the three and six months ended June 30, 2012

(Unaudited)

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## **12. RELATED PARTY TRANSACTIONS AND BALANCES (Continued)**

Included in the balance of "Prepaid expenses and other" is a note receivable from Oklahoma Physical Therapy ("OPT") in the amount of \$51. Certain owners of OPT are also indirect non-controlling owners of OSH.

The Corporation advanced loans to certain indirect non-controlling physician owners of Newport Coast. As of June 30, 2012, \$45 was owing to the Corporation and as of December 31, 2011, \$17 was owing to the Corporation in respect of such loans.

## **13. COMMITMENTS AND CONTINGENCIES**

### **13.1 Commitments**

In the normal course of operations, the Centers lease certain equipment under non-cancellable long-term leases and enter into various commitments with third parties. In addition, certain of the Centers lease their facility space from related and non-related parties.

### **13.2 Contingencies**

In the normal course of business, the Centers are, from time to time, subject to allegations that may result in litigation. Certain allegations may not be covered by the Centers' commercial and liability insurance. The Centers evaluate such allegations by conducting investigations to determine the validity of each potential claim. Based on the advice of the legal counsel, management records an estimate of the amount of the ultimate expected loss for each of these matters. Events could occur that would cause the estimate of the ultimate loss to differ materially from the amounts recorded.