

Interim Condensed Consolidated Financial Statements of

**MEDICAL FACILITIES  
CORPORATION**

For the three months ended March 31, 2013  
(Unaudited)  
(In U.S. dollars)

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# MEDICAL FACILITIES CORPORATION

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

	Note	March 31, 2013 \$ (unaudited)	December 31, 2012 \$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		40,812	35,376
Short-term bank deposits		7,139	11,284
Accounts receivable		44,789	46,875
Supply inventory		5,407	5,654
Prepaid expenses and other		3,650	4,049
Income tax receivable		675	6,936
<b>Total current assets</b>		<b>102,472</b>	<b>110,174</b>
<b>Non-current assets</b>			
Foreign exchange forward contracts		-	1,507
Deferred income tax assets	7	38,886	37,520
Investment in and loan receivable from an associate		277	289
Property and equipment		65,630	64,340
Goodwill		104,696	104,696
Other intangibles		117,161	121,265
<b>Total non-current assets</b>		<b>326,650</b>	<b>329,617</b>
<b>TOTAL ASSETS</b>		<b>429,122</b>	<b>439,791</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Current liabilities</b>			
Accrued interest payable		1,959	607
Dividends payable		2,641	2,669
Accounts payables		11,397	14,744
Accrued liabilities		13,067	16,198
Current portion of long-term debt		8,844	13,959
7.5% debentures	11	44,283	45,729
<b>Total current liabilities</b>		<b>82,191</b>	<b>93,906</b>
<b>Non-current liabilities</b>			
Long-term debt		33,427	27,685
Foreign exchange forward contracts		430	-
5.9% debentures		42,685	42,434
Exchangeable interest liability		93,321	85,726
<b>Total non-current liabilities</b>		<b>169,863</b>	<b>155,845</b>
<b>Total liabilities</b>		<b>252,054</b>	<b>249,751</b>
<b>Equity</b>			
Share capital		365,896	361,936
Deficit		(241,575)	(227,014)
<b>Equity attributable to owners of the Corporation</b>		<b>124,321</b>	<b>134,922</b>
<b>Non-controlling interest</b>		<b>52,747</b>	<b>55,118</b>
<b>Total equity</b>		<b>177,068</b>	<b>190,040</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>429,122</b>	<b>439,791</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)

	Note	Attributable to Owners of the Corporation			Non-controlling Interest	Total Equity
		Share Capital	Deficit	Total		
		\$	\$	\$	\$	\$
<b>2013</b>						
Balance at December 31, 2012		361,936	(227,014)	134,922	55,118	190,040
Net income (loss) and comprehensive income (loss)		-	(7,308)	(7,308)	7,517	209
Dividends to owners of the Corporation		-	(7,883)	(7,883)	-	(7,883)
Distributions to non-controlling interest		-	-	-	(9,888)	(9,888)
Conversion of 7.5% debentures into common shares		4,070	630	4,700	-	4,700
Purchase of common shares under normal course issuer bid	4	(110)	-	(110)	-	(110)
<b>Balance at March 31, 2013</b>		<b>365,896</b>	<b>(241,575)</b>	<b>124,321</b>	<b>52,747</b>	<b>177,068</b>
<b>2012</b>						
Balance at December 31, 2011		361,935	(228,352)	133,583	18,241	151,824
Net income and comprehensive income		-	4,160	4,160	8,006	12,166
Dividends to owners of the Corporation		-	(7,815)	(7,815)	-	(7,815)
Distributions to non-controlling interest		-	-	-	(7,224)	(7,224)
<b>Balance at March 31, 2012</b>		<b>361,935</b>	<b>(232,007)</b>	<b>129,928</b>	<b>19,023</b>	<b>148,951</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 March 31,	
		2013 \$	2012 \$
<b>Facility service revenue</b>		<b>72,891</b>	<b>58,909</b>
<b>Operating expenses</b>			
Salaries and benefits		19,556	13,922
Drugs and supplies		20,060	14,142
General and administrative		10,679	7,193
Depreciation of property and equipment		2,191	1,714
		<b>52,486</b>	<b>36,971</b>
<b>Income from operations</b>		<b>20,405</b>	<b>21,938</b>
<b>Amortization of other intangibles</b>		<b>4,104</b>	<b>3,242</b>
<b>Finance costs</b>			
Interest expense, net of interest income	5	1,719	1,273
Interest expense on exchangeable interest liability		2,334	2,017
Loss (gain) on foreign currency	6	2,015	(1,667)
		<b>6,068</b>	<b>1,623</b>
<b>Income before undernoted</b>		<b>10,233</b>	<b>17,073</b>
Increase in values of convertible debentures		3,505	1,316
Increase in value of exchangeable interest liability		7,595	3,077
<b>Income (loss) before income taxes</b>		<b>(867)</b>	<b>12,680</b>
Income tax expense (recovery)	7	(1,076)	514
<b>Net income and comprehensive income for the period</b>		<b>209</b>	<b>12,166</b>
<b>Attributable to:</b>			
Owners of the Corporation		(7,308)	4,160
Non-controlling interest		7,517	8,006
		<b>209</b>	<b>12,166</b>
<b>Basic and fully diluted earnings (loss) per share attributable to owners of the Corporation</b>	8	<b>\$ (0.258)</b>	<b>\$ 0.147</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)

	Note	Three Months Ended March 31,	
		2013 \$	2012 \$
<b>Cash flows from operating activities</b>			
Net income and comprehensive income for the period		209	12,166
Adjustments for:			
Depreciation of property and equipment		2,191	1,714
Amortization of other intangibles		4,104	3,242
Share of equity loss in an associate		2	3
Increase in values of convertible debentures		3,505	1,316
Increase in value of exchangeable interest liability		7,595	3,077
Interest expense, net of interest income	5	1,719	1,273
Loss (gain) on foreign currency	6	2,015	(1,667)
Deferred income tax recovery	7	(1,366)	(796)
Current income tax expense	7	290	1,310
Interest paid		(1,838)	(483)
Income and withholding taxes received		5,970	3,115
Change in non-cash operating working capital		(2,467)	(4,267)
<b>Net cash provided by operating activities</b>		<b>21,929</b>	<b>20,003</b>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment		(3,481)	(2,293)
Redemption of (investment in) short-term bank deposits		4,145	(2,206)
Redemption of long-term bank deposits		-	2,526
Release of collateral on foreign exchange forward contracts		-	4,483
Cash interest received		192	57
<b>Net cash provided by investing activities</b>		<b>856</b>	<b>2,567</b>
<b>Cash flows from financing activities</b>			
Proceeds from revolving credit facilities at the Centers		1,930	96
Repayments of notes payable and obligations under lease arrangements at the Centers		(1,303)	(795)
Distributions, return of capital and loan receivable from an associate		10	24
Distributions to non-controlling interest		(9,888)	(7,224)
Dividends paid		(7,910)	(7,779)
Purchase of common shares under the terms of normal course issuer bid	4	(110)	-
<b>Net cash used in financing activities</b>		<b>(17,271)</b>	<b>(15,678)</b>
<b>Increase in cash and cash equivalents</b>			
Effect of exchange rate fluctuations on cash balances held		(78)	942
Cash and cash equivalents, beginning of the period		35,376	17,984
<b>Cash and cash equivalents, end of the period</b>		<b>40,812</b>	<b>25,818</b>

Non-cash transaction:

Conversion of 7.5% debentures into common shares	4,700	-
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The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Notes to Interim Condensed Consolidated Financial Statements  
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)  
For the three months ended March 31, 2013  
(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 six 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 March 31,	
		2013	2012
Black Hills Surgical Hospital, LLP	Rapid City, South Dakota	54.2%	54.2%
Sioux Falls Specialty Hospital, LLP	Sioux Falls, South Dakota	51.0%	51.0%
Dakota Plains Surgical Center, LLP	Aberdeen, South Dakota	64.6%	64.6%
Oklahoma Spine Hospital, LLC	Oklahoma City, Oklahoma	58.5%	57.8%
The Surgery Center of Newport Coast, LLC	Newport Beach, California	51.0%	51.0%
Arkansas Surgical Hospital, L.L.C.	North Little Rock, Arkansas	51.0%	-

## 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, 2012. 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, 2012.

These interim condensed consolidated financial statements were approved by the Corporation’s board of directors on May 14, 2013.

### 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.

# 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 months ended March 31, 2013  
(Unaudited)

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## **2. BASIS OF PREPARATION (Continued)**

### **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.

The Corporation translates monetary assets and liabilities denominated in Canadian dollars, principally its convertible debentures, exchangeable interest liability and certain of its cash balances, 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 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. Such differences in estimates are recognized when the estimates are revised.

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 in respect of (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 contingencies and (vii) income tax provisions.

The preliminary purchase price allocation for the acquisition of Arkansas Surgical Hospital, L.L.C. as presented in note 4.1 to the Corporation's audited consolidated financial statements for the year ended December 31, 2012 has not changed since December 31, 2012 and was finalized in the first quarter of 2013.



# 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 months ended March 31, 2013

(Unaudited)

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## 3. NEWLY ADOPTED ACCOUNTING PRONOUNCEMENTS

The Corporation adopted the following accounting pronouncements effective January 1, 2013:

1. IFRS 10, *Consolidated Financial Statements* which replaces guidance on the control and consolidation requirements in IAS 27, *Separate Financial Statements*. There was no impact on the financial statements as a result of adopting IFRS 10.
2. IFRS 12, *Disclosure of Interests in Other Entities* which requires extensive disclosures relating to an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. There was no impact on the financial statements as a result of adopting IFRS 12.
3. IFRS 13, *Fair Value Measurement* which provides a revised definition of fair value, establishes a framework for measuring fair value and sets out disclosure requirements for when fair value measurement is required or permitted under International Financial Reporting Standards. There was no impact on the financial statements as a result of adopting IFRS 13.
4. Amendments to IAS 1, *Presentation of Financial Statements* which require the grouping together of other comprehensive income ("OCI") items that may be reclassified to the Statement of Earnings within OCI. There was no impact on the financial statements as a result of adopting amendments to IAS 1.
5. Amendments to IAS 19, *Employee Benefits* which require the recognition of changes in defined benefit obligations and in fair value of plan assets when they occur and accelerate the recognition of past service costs. There was no impact on the financial statements as a result of adopting amendments to IAS 19.

## 4. NORMAL COURSE ISSUER BID

Pursuant to the terms of the Corporation's normal course issuer bid in effect from May 15, 2012 to May 14, 2013, during the three-month period ended March 31, 2013, the Corporation purchased 7,600 of its common shares for a total consideration of \$110, recorded in share capital. All common shares acquired under this bid were cancelled.

On May 13, 2013, the Corporation received regulatory approval for a normal course issuer bid to purchase up to 628,287 of its outstanding common shares during the period from May 15, 2013 to May 14, 2014.

# 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 months ended March 31, 2013

(Unaudited)

## 5. INTEREST EXPENSE, NET OF INTEREST INCOME

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

	Three Months Ended March 31,	
	2013 \$	2012 \$
Interest expense at Centers' level	433	477
Interest expense on convertible debentures	1,391	797
Amortization of available line of credit stand-by fees	87	56
Interest income	(192)	(57)
<b>Interest expense, net of interest income</b>	<b>1,719</b>	<b>1,273</b>

## 6. LOSS (GAIN) ON FOREIGN CURRENCY

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

	Three Months Ended March 31,	
	2013 \$	2012 \$
Unrealized loss (gain) on foreign exchange forward contracts	1,937	(725)
Realized loss (gain) on foreign exchange forward contracts which matured in the current period	(428)	(759)
Translation loss (gain) on cash balances denominated in Cdn\$	506	(183)
<b>Loss (gain) on foreign currency</b>	<b>2,015</b>	<b>(1,667)</b>

Unrealized loss (gain) on convertible debentures is included in the statement of comprehensive income as part of the "Increase in values of convertible debentures".

# 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 months ended March 31, 2013

(Unaudited)

## 7. INCOME TAXES

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

	March 31, 2013 \$	December 31, 2012 \$
Deferred income tax assets related to U.S. tax entity	13,586	11,020
Deferred income tax assets related to Canadian tax entity	25,300	26,500
<b>Deferred income tax assets</b>	<b>38,886</b>	<b>37,520</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 March 31,	
	2013 \$	2012 \$
Current income tax expense	290	1,310
Deferred income tax recovery	(1,366)	(796)
<b>Income tax expense (recovery)</b>	<b>(1,076)</b>	<b>514</b>

## 8. EARNINGS (LOSS) PER SHARE

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

	Three Months Ended March 31,	
	2013 \$	2012 \$
Net income (loss) and comprehensive income (loss) for the period attributable to owners of the Corporation	(7,308)	4,160
Divided by weighted average number of common shares outstanding for the period	28,352,341	28,310,042
<b>Basic earnings (loss) per share attributable to owners of the Corporation</b>	<b>(0.258)</b>	<b>0.147</b>

For the three months ended March 31, 2013 and March 31, 2012, issuance of common shares upon exchange of the outstanding exchangeable interest liability and conversion of the outstanding convertible debentures would have been anti-dilutive and, therefore, the calculation of fully diluted earnings (loss) per share is not presented.

# 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 months ended March 31, 2013  
(Unaudited)

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## 9. 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 the exchange amounts 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 months ended March 31, 2013 were \$3,911 and for the three months ended March 31, 2012 were \$3,409.

The amounts payable to the related parties, included in accounts payable, as of March 31, 2013 were \$1,250 and as of December 31, 2012 were \$1,967.

### 9.1 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 four such individuals perform the duties of Medical Director at the respective Centers and are compensated in recognition of their contribution to the Centers.

## 10. COMPARATIVE INFORMATION

The Corporation made the following reclassifications to the previously reported interim consolidated statements of comprehensive income for the three months ended March 31, 2012, none of which resulted in changes to net income and comprehensive income:

- (i) Bad debt expense of \$1,067 was reclassified from line item "General and administrative" to line item "Facility service revenue";
- (ii) Depreciation of property and equipment of \$1,714 was reclassified from line item "Depreciation and amortization" and included as "Depreciation of property and equipment" in "Operating expenses". The line item "Depreciation and amortization" was renamed "Amortization of other intangibles"; and
- (iii) Unrealized loss on convertible debentures of \$844 was reclassified from line item "Loss (gain) on foreign currency" to line item "Increase in values of convertible debentures".

As a result of these reclassifications, for the three months ended March 31, 2012, (i) facility service revenue and general and administrative expenses decreased by \$1,067; (ii) operating expenses increased by \$647; (iii) income from operations decreased by \$1,714; and (iv) loss (gain) on foreign currency and change in value of convertible debentures each increased by \$844.

# 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 months ended March 31, 2013

(Unaudited)

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## 11. SUBSEQUENT EVENT

The Corporation's Cdn\$42,979 (US\$42,659) principal amount of 7.5% convertible secured debentures ("7.5% debentures") matured on April 30, 2013. Under the terms of the Trust Indenture, the holders of the 7.5% debentures had the right to convert their holdings into common shares at a conversion price of \$13.10 per common share. From June 18, 2012 (the first conversion) through April 30, 2013, Cdn\$41,201 (US\$40,894) principal amount of 7.5% debentures were converted into 3,145,093 common shares. On April 30, 2013, the Corporation redeemed the remaining outstanding principal amount of Cdn\$1,778 (US\$1,765) for cash.