

Interim Condensed Consolidated Financial Statements of

**MEDICAL FACILITIES  
CORPORATION**

For the three and six months ended June 30, 2014  
(Unaudited)  
(In U.S. dollars)

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# MEDICAL FACILITIES CORPORATION

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

	Note	June 30, 2014 \$	December 31, 2013 \$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		31,383	35,872
Short-term investments		10,392	9,065
Accounts receivable		39,442	50,332
Supply inventory		5,687	5,527
Prepaid expenses and other		3,365	4,046
Income tax receivable		2,784	1,118
<b>Total current assets</b>		<b>93,053</b>	<b>105,960</b>
<b>Non-current assets</b>			
Long-term investments		3,831	3,807
Restricted cash		1,802	-
Deferred income tax assets	7	47,059	50,656
Investment in and loan receivable from an associate		439	421
Property and equipment		66,546	68,200
Goodwill		104,211	104,211
Other intangibles		96,368	104,622
<b>Total non-current assets</b>		<b>320,256</b>	<b>331,917</b>
<b>TOTAL ASSETS</b>		<b>413,309</b>	<b>437,877</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Current liabilities</b>			
Dividends payable		2,755	2,765
Accounts payables		10,926	14,965
Accrued liabilities		13,690	15,328
Current portion of long-term debt		23,066	24,544
<b>Total current liabilities</b>		<b>50,437</b>	<b>57,602</b>
<b>Non-current liabilities</b>			
Long-term debt		16,947	17,875
Foreign exchange forward contracts		1,511	2,809
5.9% debentures		41,175	41,266
Exchangeable interest liability		104,864	105,841
<b>Total non-current liabilities</b>		<b>164,497</b>	<b>167,791</b>
<b>Total liabilities</b>		<b>214,934</b>	<b>225,393</b>
<b>Equity</b>			
Share capital		400,760	401,033
Deficit		(252,489)	(243,585)
<b>Equity attributable to owners of the Corporation</b>		<b>148,271</b>	<b>157,448</b>
<b>Non-controlling interest</b>		<b>50,104</b>	<b>55,036</b>
<b>Total equity</b>		<b>198,375</b>	<b>212,484</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>413,309</b>	<b>437,877</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>2014</b>						
Balance at December 31, 2013		401,033	(243,585)	157,448	55,036	212,484
Net income and comprehensive income for the period		-	7,200	7,200	13,962	21,162
Dividends to owners of the Corporation		-	(16,104)	(16,104)	-	(16,104)
Distributions to non-controlling interest		-	-	-	(18,894)	(18,894)
Conversion of 5.9% debentures into common shares		13	-	13	-	13
Purchase of common shares under normal course issuer bids	4	(286)	-	(286)	-	(286)
<b>Balance at June 30, 2014</b>		<b>400,760</b>	<b>(252,489)</b>	<b>148,271</b>	<b>50,104</b>	<b>198,375</b>
<b>2013</b>						
Balance at December 31, 2012		361,936	(227,014)	134,922	55,118	190,040
Net income and comprehensive income for the period		-	94	94	14,869	14,963
Dividends to owners of the Corporation		-	(16,371)	(16,371)	-	(16,371)
Distributions to non-controlling interest		-	-	-	(18,166)	(18,166)
Acquisition of additional interest in Oklahoma Spine Hospital, LLC		299	-	299	-	299
Equity contribution by non-controlling interests to Black Hills Surgical Hospital, LLP		-	-	-	580	580
Conversion of 7.5% debentures into common shares		40,013	5,425	45,438	-	45,438
Purchase of common shares under normal course issuer bids		(1,199)	-	(1,199)	-	(1,199)
<b>Balance at June 30, 2013</b>		<b>401,049</b>	<b>(237,866)</b>	<b>163,183</b>	<b>52,401</b>	<b>215,584</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 June 30,		Six Months Ended June 30,	
		2014 \$	2013 \$	2014 \$	2013 \$
<b>Facility service revenue</b>		<b>74,353</b>	<b>73,677</b>	<b>147,246</b>	<b>146,568</b>
<b>Operating expenses</b>					
Salaries and benefits		20,123	19,439	40,349	38,995
Drugs and supplies		20,667	20,707	41,337	40,768
General and administrative		10,767	10,405	22,224	21,084
Depreciation of property and equipment		2,509	2,312	4,988	4,503
		<b>54,066</b>	<b>52,863</b>	<b>108,898</b>	<b>105,350</b>
<b>Income from operations</b>		<b>20,287</b>	<b>20,814</b>	<b>38,348</b>	<b>41,218</b>
Amortization of other intangibles		4,149	4,149	8,253	8,254
<b>Finance costs</b>					
Interest expense, net of interest income	5	890	1,142	1,841	2,862
Interest expense on exchangeable interest liability		2,132	1,939	4,690	4,273
Loss (gain) on foreign currency	6	(2,598)	3,079	510	5,093
		<b>424</b>	<b>6,160</b>	<b>7,041</b>	<b>12,228</b>
Increase (decrease) in values of convertible debentures		(971)	(3,232)	(78)	272
Increase (decrease) in value of exchangeable interest liability		(11,977)	(4,609)	(977)	2,989
<b>Income before income taxes</b>		<b>28,662</b>	<b>18,346</b>	<b>24,109</b>	<b>17,475</b>
Income tax expense	7	5,548	3,588	2,947	2,512
<b>Net income and comprehensive income for the period</b>		<b>23,114</b>	<b>14,758</b>	<b>21,162</b>	<b>14,963</b>
<b>Attributable to:</b>					
Owners of the Corporation		15,770	7,406	7,200	94
Non-controlling interest		7,344	7,352	13,962	14,869
		<b>23,114</b>	<b>14,758</b>	<b>21,162</b>	<b>14,963</b>
<b>Basic earnings per share attributable to owners of the Corporation</b>	8	<b>\$ 0.503</b>	<b>\$ 0.241</b>	<b>\$ 0.230</b>	<b>\$ 0.003</b>
<b>Fully diluted earnings per share attributable to owners of the Corporation</b>	8	<b>\$ 0.243</b>	<b>\$ 0.096</b>	<b>\$ 0.230</b>	<b>\$ 0.003</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	Six Months Ended June 30,	
		2014 \$	2013 \$
<b>Cash flows from operating activities</b>			
Net income and comprehensive income for the period		21,162	14,963
Adjustments for:			
Depreciation of property and equipment		4,988	4,503
Amortization of other intangibles		8,253	8,254
Share of equity income in an associate		(73)	(4)
Increase (decrease) in values of convertible debentures		(78)	272
Increase (decrease) in value of exchangeable interest liability		(977)	2,989
Interest expense, net of interest income	5	1,841	2,862
Loss on foreign currency	6	510	5,093
Deferred income tax expense	7	3,597	1,707
Current income tax expense (recovery)	7	(650)	805
Interest paid		(1,946)	(3,001)
Income and withholding taxes (paid) received		(1,016)	4,009
Change in non-cash operating working capital		5,556	(5,248)
<b>Net cash provided by operating activities</b>		<b>41,167</b>	<b>37,204</b>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment, net of disposals		(3,334)	(7,792)
Investment in short-term investments		(1,327)	(2,914)
Investment in long-term investments		(24)	-
Collateral posted on foreign exchange forward contracts classified as restricted cash		(1,802)	-
Cash interest received		284	304
<b>Net cash used in investing activities</b>		<b>(6,203)</b>	<b>(10,402)</b>
<b>Cash flows from financing activities</b>			
Proceeds from revolving credit facilities at the Centers		49	4,981
Repayments of notes payable and obligations under lease arrangements at the Centers		(2,455)	(3,010)
Distributions, return of capital and loan receivable from an associate		55	15
Distributions to non-controlling interest		(18,894)	(18,166)
Dividends paid		(16,114)	(16,244)
Equity contribution by non-controlling interests to Black Hills Surgical Hospital, LLP		-	580
Redemption of 7.5% debentures		-	(1,765)
Purchase of common shares under the terms of normal course issuer bids	4	(286)	(1,199)
<b>Net cash used in financing activities</b>		<b>(37,645)</b>	<b>(34,808)</b>
<b>Decrease in cash and cash equivalents</b>		<b>(2,681)</b>	<b>(8,006)</b>
Effect of exchange rate fluctuations on cash balances held		(1,808)	(629)
Cash and cash equivalents, beginning of the period		35,872	35,376
<b>Cash and cash equivalents, end of the period</b>		<b>31,383</b>	<b>26,741</b>
Non-cash transaction:			
Acquisition of additional interests in Oklahoma Spine Hospital, LLC		-	299
Conversion of 7.5% debentures into common shares		-	45,438
Conversion of 5.9% debentures into common shares		13	-

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 and six months ended June 30, 2014  
(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 June 30,	
		2014	2013
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	58.8%	58.8%
The Surgery Center of Newport Coast, LLC (“Newport Coast”)	Newport Beach, California	51.0%	51.0%
Arkansas Surgical Hospital, L.L.C. (“ASH”)	North Little Rock, Arkansas	51.0%	51.0%

## 2. BASIS OF PREPARATION

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 (“IASB”) 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, 2013. These unaudited interim condensed consolidated financial statements do not contain all of the disclosures that are required in annual financial statements prepared under International Financial Reporting Standards (“IFRS”) and should be read in conjunction with the Corporation’s audited consolidated financial statements for the year ended December 31, 2013, which includes information necessary or useful to understand the Corporation’s business and financial statement presentation.

These interim condensed consolidated financial statements are presented in United States dollars.

These interim condensed consolidated financial statements were approved by the Corporation’s board of directors on August 13, 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 and six months ended June 30, 2014  
(Unaudited)

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## 3. NEW AND REVISED IFRS NOT YET ADOPTED

The Corporation has not applied the following new and revised IFRS that have been issued but are not yet effective.

### 3.1 IFRS 9, *Financial Instruments*

The IASB has completed its project to replace IAS 39, *Financial Instruments: Recognition and Measurement* with IFRS 9, *Financial Instruments*. The IASB first issued IFRS 9 in 2009 with a new classification and measurement model for financial assets followed by requirements for financial liabilities and derecognition added in 2010. Subsequently, IFRS 9 was amended in 2013 to add new general hedge accounting requirements. IFRS 9 has a mandatory effective date for annual periods beginning on or after January 1, 2018, with earlier application permitted. IFRS 9 is applied retrospectively with some exceptions but entities need not restate prior periods in relation to classification and measurement. The full version of IFRS 9 will supersede all previous versions of the standard. However, for annual periods beginning before January 1, 2018, an entity may elect to apply those earlier versions of IFRS 9 if the entity's relevant date of initial application is before February 1, 2015. The Corporation is currently assessing the impact of IFRS 9 on its financial statements.

### 3.2 IFRS 15, *Revenue from Contracts with Customers*

In May 2014, the IASB issued a new standard, IFRS 15, *Revenue from Contracts with Customers*, which supersedes current revenue recognition guidance, including IAS 18, *Revenues*, IAS 11, *Construction Contracts* and related Interpretations and is convergent with a new U.S. GAAP standard issued at the same time. IFRS 15 specifies how and when to recognise revenue, providing for a single, principles based five-step model to be applied to all contracts with customers. IFRS 15 defines revenue as income arising in the course of an entity's ordinary activities. The standard's core principle is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. IFRS 15 is effective for reporting periods beginning on or after January 1, 2017, with early application permitted. The Corporation is currently assessing the impact of IFRS 15 on its financial statements.



# MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements  
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## 3. NEW AND REVISED IFRS NOT YET ADOPTED (Continued)

### 3.3 Annual improvements to IFRS (2010 – 2012) and (2011 – 2013) cycles

In December 2013, the IASB issued narrow-scope amendments to a total of nine standards as part of its annual improvements process. The IASB uses the annual improvements process to make non-urgent but necessary amendments to IFRS. Most amendments will apply prospectively for annual periods beginning on or after July 1, 2014. Earlier application is permitted, in which case, the related consequential amendments to other IFRS would also apply.

The Corporation intends to adopt these amendments in its financial statements for the annual period beginning on January 1, 2015. The extent of the impact of adoption of the amendments has not yet been determined.

## 4. NORMAL COURSE ISSUER BIDS

Under its normal course issuer bids, during the three-month and six-month periods ended June 30, 2014, the Corporation purchased 16,500 of its common shares for a total consideration of \$286. During the three-month period ended June 30, 2013, the Corporation purchased 74,700 of its common shares for a total consideration of \$1,090. During the six-month period ended June 30, 2013, the Corporation purchased 82,300 of its common shares for a total consideration of \$1,199. The purchases under the bids are recorded in share capital. All common shares acquired under the bids were cancelled.

## 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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	\$	\$	\$	\$
Interest expense at Centers' level	425	443	841	876
Interest expense on convertible debentures	568	719	1,119	2,110
Amortization of available line of credit stand-by fees	81	93	165	180
Interest income	(184)	(113)	(284)	(304)
<b>Interest expense, net of interest income</b>	<b>890</b>	<b>1,142</b>	<b>1,841</b>	<b>2,862</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)  
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(Unaudited)

## 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 June 30,		Six Months Ended June 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Unrealized loss (gain) on foreign exchange forward contracts	(2,942)	2,527	(1,298)	4,464
Realized loss (gain) on foreign exchange forward contracts which matured in the current period	800	(71)	1,639	(499)
Translation loss (gain) on cash balances denominated in Cdn\$	(456)	623	169	1,128
<b>Loss (gain) on foreign currency</b>	<b>(2,598)</b>	<b>3,079</b>	<b>510</b>	<b>5,093</b>

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

## 7. INCOME TAXES

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

	June 30, 2014 \$	December 31, 2013 \$
Deferred income tax assets related to U.S. tax entity	15,559	16,756
Deferred income tax assets related to Canadian tax entity	31,500	33,900
<b>Deferred income tax assets</b>	<b>47,059</b>	<b>50,656</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 June 30,		Six Months Ended June 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Current income tax expense (recovery)	(95)	515	(650)	805
Deferred income tax expense	5,643	3,073	3,597	1,707
<b>Income tax expense</b>	<b>5,548</b>	<b>3,588</b>	<b>2,947</b>	<b>2,512</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)  
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(Unaudited)

## 8. EARNINGS (LOSS) PER SHARE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014 \$	2013 \$	2014 \$	2013 \$
Net income and comprehensive income for the period attributable to owners of the Corporation	15,770	7,406	7,200	94
Divided by weighted average number of common shares outstanding for the period	31,356,408	30,768,123	31,361,550	29,566,906
<b>Basic earnings per share attributable to owners of the Corporation</b>	<b>0.503</b>	<b>0.241</b>	<b>0.230</b>	<b>0.003</b>

For the three months ended June 30, 2014 and June 30, 2013, fully diluted earnings per share are calculated as follows:

	Three Months Ended June 30,	
	2014 \$	2013 \$
Net income and comprehensive income for the period attributable to owners of the Corporation	15,770	7,406
Decrease in values of convertible debentures	(971)	(3,232)
Interest expense on convertible debentures (tax effected)	418	719
Decrease in value of exchangeable interest liability (tax effected)	(7,665)	(2,950)
Interest expense on exchangeable interest liability	2,132	1,939
Modified net income and comprehensive income for the period attributable to owners of the Corporation	9,684	3,882
Divided by:		
Weighted average number of common shares outstanding for the period	31,356,408	30,768,123
Number of common shares deemed to be issued on the conversion of the outstanding convertible debentures	2,186,969	3,655,046
Number of common shares deemed to be issued on the exchange of the outstanding exchangeable interest liability	6,255,873	6,159,426
Weighted average number of common shares	39,799,250	40,582,595
<b>Fully diluted earnings per share</b>	<b>0.243</b>	<b>0.096</b>

For the six-month periods ended June 30, 2014 and June 30, 2013, 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)  
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(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 and six months ended June 30, 2014 were \$3,875 and \$8,609, respectively, and for the three and six months ended June 30, 2013 were \$4,010 and \$7,890, respectively.

The amounts payable to the related parties, included in accounts payable, as of June 30, 2014 were \$582 and as of December 31, 2013 were \$552.

### 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.