EXTENDICARE®

... helping people live better

MANAGEMENT'S DISCUSSION AND ANALYSIS

Six Months Ended June 30, 2016

Dated: August 11, 2016

THE RIGHT CARE

THE RIGHT PLACE

THE RIGHT TIME

Management's Discussion and Analysis

August 11, 2016

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BASIS OF PRESENTATION

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

Extendicare and its predecessors have been in operation since 1968, providing care and services to seniors in North America. On July 1, 2015, Extendicare completed the sale of substantially all of its U.S. business and senior care operations (the "U.S. Sale Transaction"), the operations of which were conducted through its wholly owned U.S. subsidiary, Extendicare Health Services, Inc. and its subsidiaries (collectively "EHSI"). This transaction was part of the Company's strategic objective to be a leading provider of care and services for seniors focused solely in Canada. As a result of the sale of the U.S. Sale Transaction, EHSI's operations to the date of sale were classified as discontinued operations. For further information, refer to the discussion under the heading "Other Significant Developments – 2015 U.S. Sale Transaction" and to *note 17* of the unaudited interim condensed consolidated financial statements.

In the 2016 second quarter, the board of directors of Extendicare (the "Board") concluded that the Company should dispose of its non-strategic wholly owned U.S. information technology hosting and professional services business, Virtual Care Provider, Inc. (VCPI), which had been retained following the 2015 U.S. Sale Transaction. As a result, the Company has classified VCPI's assets and liabilities as held for sale as at June 30, 2016, has reclassified its operations as discontinued, and has restated the consolidated statement of earnings (loss) on a comparative basis. For further information, refer to the discussion under the heading "Significant 2016 Events and Developments – Disposal Group Held for Sale – VCPI" and to *notes 5 and 17* of the unaudited interim condensed consolidated financial statements.

Extendicare has prepared this MD&A to provide information to assist its current and prospective investors' understanding of Extendicare's financial results for the three and six months ended June 30, 2016. This MD&A should be read in conjunction with Extendicare's unaudited interim condensed consolidated financial statements for the three and six months ended June 30, 2016, and the notes thereto, together with the MD&A and the audited consolidated financial statements for the year ended 2015, and the notes thereto, found in Extendicare's 2015 Annual Report. The accompanying unaudited interim condensed consolidated financial statements for the three and six months ended June 30, 2016, including the notes thereto, have been prepared in accordance with International Financial Reporting Standards (IFRS) for interim financial statements. These financial statements and notes are available on Extendicare's website at www.extendicare.com. Additional information about Extendicare, including its latest Annual Information Form, can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com under Extendicare's issuer profile.

All currencies are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2015, or December 31 of the year referenced.

The discussion and analysis in this MD&A are based upon information available to management as of August 11, 2016. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other events may or may not occur, which could affect the Company in the future.

ADDITIONAL INFORMATION

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

FORWARD-LOOKING STATEMENTS

Information provided by Extendicare from time to time, including in this Quarterly 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 Extendicare's business operations, business strategy, growth strategy, results of operations and financial condition; the U.S. Sale Transaction, including statements relating to indemnification provisions, and the net benefit (pre-tax) of an ongoing cash stream relating to certain U.S. skilled nursing centres that were leased prior to the closing of the U.S. Sale Transaction; and the acquisition and development of retirement communities, including statements related to the expected annual revenue, net operating income, stabilized net operating income yield, and adjusted funds from operations to be derived from acquisitions and development projects. Forward-looking statements can be identified by the expressions "anticipate", "believe", "estimate", "expect", "intend", "objective", "plan", "project", "will" or other similar expressions or the negative thereof. These forward-looking statements reflect the Company's current expectations regarding future results, performance or achievements and are based upon information currently available to the Company and on assumptions that the Company believes are reasonable.

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

The forward-looking statements contained in this Quarterly 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 Quarterly Report. Except as required by applicable securities laws, the Company assumes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

NON-GAAP MEASURES

Extendicare assesses and measures operating results and financial position based on performance measures referred to as "net operating income", "net operating income margin", "EBITDA", "Adjusted EBITDA", "Adjusted EBITDA margin", "earnings before depreciation, amortization, loss from asset impairment, disposal and other expense (income)", "earnings (loss) from continuing operations before separately reported items, net of taxes", "Funds from Operations", and "Adjusted Funds from Operations". These measures are commonly used by Extendicare and its investors as a means of assessing the performance of the core operations in comparison to prior periods. They are presented by Extendicare on a consistent basis from period to period, thereby allowing for consistent comparability of its operating performance. 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", or "NOI", in this document are to revenue less operating expenses, and this value represents the underlying performance of our operating business segments. References to "net operating income margin" are to net operating income as a percentage of revenue.

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

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

"Funds from Operations", or "FFO", is defined as Adjusted EBITDA less depreciation for furniture, fixtures, equipment and computers, or "depreciation for FFEC", accretion costs, net interest expense, and current income taxes. Depreciation for FFEC is considered representative of the amount of maintenance (non-growth) capital expenditures, or "maintenance capex", to be used in determining "Funds from Operations", as the depreciation term is generally in line with the life of these assets.

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

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

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

Reconciliations of "earnings (loss) from continuing operations before income taxes" to "Adjusted EBITDA" and "net operating income" are provided under the headings "2016 Selected Quarterly Information", "2016 First Quarter Financial Review" and "Six Month Financial Review".

Reconciliations of "Adjusted EBITDA" to "FFO" and "AFFO" are provided under the heading "Adjusted Funds from Operations".

Reconciliations of "AFFO" to "net cash from operating activities" are provided under the heading "Adjust Funds from Operations – Reconciliation of Net Cash from Operating Activities to AFFO".

BUSINESS STRATEGY

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

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

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

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

SIGNIFICANT 2016 EVENTS AND DEVELOPMENTS

This section provides an update on our current activities to expand into the Canadian retirement sector and to dispose of our U.S. information technology business. Refer to the discussion under the heading “Other Significant Developments” for a summary of other developments affecting the financial results or operations of Extendicare.

Expansion into Private-pay Retirement Sector

As part of the execution of our strategy to grow along the senior care and services continuum, we are expanding into the private-pay retirement sector through the acquisition and development of retirement communities. Expansion in the retirement sector will assist us in diversifying our revenue through additional non-government revenue streams.

The following table summarizes our acquisition and development activities with respect to the private-pay retirement sector.

Name/Location	Acquisition / Opening Date	# of Communities	Suites	Purchase Price / Development Cost *(millions)* [1]	Price per Suite	Expected Stabilized NOI Yield [2]
Completed in Q4-2015						
Empire Crossing, Port Hope, ON	Oct. 1, 2015	1	64	$20.2	$315,600	6.9% to 7.1%
Harvest, Tillsonburg, ON	Dec. 1, 2015	1	100	$28.4	$284,500	6.7% to 6.9%
Stonebridge Crossing, Saskatoon, and Riverbend Crossing, Regina, SK	Dec. 1, 2015	2	184	$50.3	$273,271	7.2%
Completed in Q1-2016						
West Park Crossing, Moose Jaw, and Yorkton Crossing, Yorkton, SK	Feb. 22, 2016	2	158	$40.5	$256,300	7.3% to 7.7%
In Progress at Period End						
Simcoe / Uxbridge / Bolton/ Bradford, ON	Q4/2016 / Q4/2017 / Q1/2018 / Q4/2018	4	424	$113.5	$ 267,700	7.4%

(1) Non-GAAP: purchase price includes negotiated income support arrangements to bridge the cash flow from the time of acquisition to stabilized NOI; and in connection with the development projects, estimated development costs include lease-up amounts to achieve stabilized NOI, and an imputed cost of capital.

(2) Non-GAAP: defined as stabilized NOI divided by the purchase price/development cost, and where an agreement includes income support, a range is computed based on assuming nil to 50% of the income support is released to the Company.

RETIREMENT ACQUISITIONS

During the 2015 fourth quarter, we completed the acquisition of four retirement communities for an aggregate purchase price of approximately $98.6 million, inclusive of a $0.3 million reduction for net working capital adjustments on closing, and $2.3 million for income support during the lease-up period. During the 2016 first quarter, we closed on an additional two retirement communities for an aggregate purchase price of $40.5 million, inclusive of $4.5 million for income support during the lease-up period. The aggregate purchase price of $139.4 million for these acquisitions (the "Retirement Acquisitions"), prior to working capital adjustments of $0.3 million, was paid in cash with an intention to finance the communities as stabilized occupancy is achieved. Financing on three of the communities was secured in August, refer to the discussion below under the heading "Retirement Community Financings". Further details on these acquisitions are provided below, and in *note 4* of the unaudited interim condensed consolidated financial statements.

For the three months ended June 30, 2016, the Retirement Acquisitions contributed revenue, net operating income and AFFO of approximately $3.7 million, nil, and $1.7 million ($0.019 per basic share), respectively. For the six months ended June 30, 2016, the Retirement Acquisitions contributed revenue of $7.0 million, net operating income of $0.4 million, and AFFO of approximately $3.0 million, or $0.034 per basic share, inclusive of income support of $3.1 million.

Empire Crossing Retirement Community (Empire Crossing) was acquired on October 1, 2015, for a purchase price of $20.2 million, inclusive of income support. Empire Crossing, located in Port Hope, Ontario, is a newly built 64-suite community offering independent and enhanced care services that opened in May 2015. As well, this property comes with excess land, providing us with the option to increase the size of the retirement community in the future. The vendor has provided Extendicare with income support of up to $1.3 million over 24 months, which amount was held back from the $20.2 million purchase price, and is being released to Extendicare during the lease-up period based on an agreed-upon formula.

Harvest Retirement Community (Harvest) was acquired on December 1, 2015, for a purchase price of $28.4 million, inclusive of income support. Harvest, located in Tillsonburg, Ontario, is a 100-suite independent/enhanced living community with 64 suites that opened in December 2011, and a newly constructed addition of 36 suites that opened in December 2015. The vendor has provided Extendicare with income support of up to $1.0 million over 24 months, which amount was held back from the $28.4 million purchase price, and is being released to Extendicare during the lease-up period based on an agreed-upon formula.

Stonebridge Crossing Retirement Community (Stonebridge) and ***Riverbend Crossing Memory Care Community*** (Riverbend) were acquired on December 1, 2015, for an aggregate purchase price of $50.3 million. Stonebridge, located in Saskatoon, SK, is a 116-suite independent/enhanced living community that opened in December 2012. Riverbend, located in Regina, SK, is a 68-suite community specializes in memory care services that opened in August 2013.

West Park Crossing Retirement Community (West Park) and ***Yorkton Crossing Retirement Community*** (Yorkton) were acquired on February 22, 2016, for an aggregate purchase price of $40.5 million, inclusive of income support. The properties, located in Moose Jaw and Yorkton, SK, respectively, are newly built 79-suite communities offering independent, enhanced and memory care services. The vendor has provided Extendicare with income support over 27 months of up to $2.25 million on each community, for an aggregate of up to $4.5 million in income support. This amount was held back from the $40.5 million purchase price on closing, and is being released to Extendicare during the lease-up period based on an agreed-upon formula.

RETIREMENT DEVELOPMENT PROJECTS

Extendicare has four private-pay retirement communities under development in Simcoe, Uxbridge, Bolton, and Bradford, Ontario, with a total of 424 suites. We broke ground on the Simcoe project in October 2015 and it is anticipated to open in the 2016 fourth quarter. We broke ground on the Uxbridge project in July 2016, with completion anticipated in the 2017 fourth quarter. The Bolton and Bradford communities are anticipated to be completed during 2018.

The anticipated costs to stabilization of these four development projects is approximately $113.5 million, or approximately $267,700 per suite, which amount includes an imputed cost of capital and an estimated lease-up amount to achieve stabilized NOI. The estimated average stabilized NOI yield for the four projects is 7.4%.

RETIREMENT COMMUNITY FINANCINGS

In May 2016, construction financing was secured on the first two of the development projects, Simcoe (70 suites) and Bolton (124 suites), for up to $9.9 million and $20.8 million, respectively, representing 63% of the anticipated costs. In July 2016, construction financing of up to $20.7 million was secured for the Uxbridge project. In addition, these financings provide for additional letter of credit facilities of $500,000 for the Simcoe project and $750,000 for each of the Bolton and Uxbridge projects, at a rate of 2.5% if utilized. Loan payments are interest-only, based on a floating rate of 30-day banker's acceptance rate plus 2.5%, with no standby fee. The construction loan for the Simcoe project is a demand loan that matures at the earlier of 42 months from closing or 24 months from the issuance of the occupancy permit. The construction loans for the Bolton and Uxbridge projects are demand loans that mature at the earlier of 54 months from closing or 36 months from the issuance of the occupancy permit. We anticipate securing construction financing under similar terms for the Bradford project. Permanent financing for each of the communities will be sought upon maturity of the construction financing.

In August 2016, the Company secured financing on three of the newly acquired retirement communities, Harvest, Stonebridge and Riverbend, representing non-revolving credit facilities aggregating $56.3 million, or approximately 71% of the acquisition costs. These financings have seven-year terms, with a floating rate of prime plus 0.5% or 30-day banker's acceptance rate plus 1.9%. The Company intends to enter into interest rate swaps to fix the interest rates for a minimum of 50% of each facility within 90 days.

Disposal Group Held for Sale – VCPI

In the 2016 second quarter, the Company commenced actively marketing the sale of the operations of VCPI. The Company is committed to a plan to dispose of VCPI within the next twelve months; therefore, VCPI's operations have been reclassified as discontinued. Following an assessment for impairment, the Company recognized a pre-tax impairment loss of $7.1 million (US$5.5 million) in the 2016 second quarter. As at June 30, 2016, the carrying value of these assets held for sale was $12.5 million, and the liabilities held for sale were $1.1 million, for a net book value of $11.4 million. For further information, refer to *notes 5 and 17* of the unaudited interim condensed consolidated financial statements.

BUSINESS OVERVIEW

Extendicare, through its subsidiaries, is the largest private-sector operator of long-term care centres in Canada and we believe we are the largest private-sector provider of publicly funded home health care services in Canada. For the first six months of 2016, approximately 58% of the revenue from our Canadian operations was derived from our long-term care operations, approximately 39% was from our home health care business, approximately 1% was from our retirement living operations, and the balance was from our management and group purchasing operations.

As at June 30, 2016, Extendicare operates 118 senior care and living centres in four provinces in Canada, with capacity for 15,048 residents, with a significant presence in Ontario and Alberta, where approximately 71% and 16% of its residents are served, respectively. Through its ParaMed Home Health Care (ParaMed) division, Extendicare operates from 45 locations across six provinces that, based on operations as at June 30, 2016, provided approximately 10.6 million hours of service a year, with the Ontario market representing approximately 85% of its service volumes. In May 2016, ParaMed expanded its presence in British Columbia with the addition of a four-year contract with the Vancouver Coastal Health Authority that is anticipated to add approximately 330,000 hours of service annually.

The following reflects the change in operating capacity of our Canadian senior care and living centres during the first six months of 2016 and for the 2015 year.

	Six months ended June 30, 2016		Year 2015	
Senior Care Centres	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**
As at beginning of year	**116**	**14,890**	104	13,586
Managed contracts added	–	–	8	956
Retirement communities acquired	**2**	**158**	4	348
As at end of period	**118**	**15,048**	116	14,890

All of Extendicare's centres, excluding those managed for third parties, are either owned or leased under finance lease arrangements. Nine of our centres in Ontario are operated under 25-year finance lease arrangements, with full ownership obtained at the end of the lease term. We believe that ownership of our centres provides financial and strategic advantages.

The following summarizes the senior care and living centres operated by Extendicare as at June 30, 2016, which consist of long-term care (LTC) centres, retirement communities, and a chronic care unit. For financial reporting purposes, a centre is categorized based on the predominant level of care provided, the type of licensing and the type of funding provided. Some of our long-term care centres include wings housing retirement suites. In this case, the centre and its resident capacity is categorized as LTC centres, and its operations are included as part of our LTC operating segment. In addition, government-funded supportive living suites have been categorized as LTC centres due to the nature of the regulatory oversight and fixed-fee structure determined by the government.

	Long-term Care		**Retirement Living**		**Chronic Care Unit**		**Total**	
By Province	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**	**No. of Centres**	**Resident Capacity**
Owned/Leased (1)								
Ontario	34	5,210	2	164	–	–	36	5,374
Alberta	14	1,495	–	–	–	–	14	1,495
Saskatchewan	5	649	4	342	–	–	9	991
Manitoba	5	762	–	–	–	–	5	762
	58	8,116	6	506	–	–	64	8,622
Managed								
Ontario	37	4,752	4	440	1	120	42	5,312
Alberta	4	526	6	420	–	–	10	946
Manitoba	2	168	–	–	–	–	2	168
	43	5,446	10	860	1	120	54	6,426
Total	**101**	**13,562**	**16**	**1,366**	**1**	**120**	**118**	**15,048**

(1) Extendicare operates nine long-term care centres (1,155 LTC beds and 76 retirement suites) in Ontario under 25-year finance lease arrangements maturing beginning in 2026 through to 2028, with full ownership obtained at the end of the respective lease terms.

Operating Segments

Prior to the announcement of the U.S. Sale Transaction, the Company had two reportable operating segments that consisted of its U.S. operations and its Canadian operations. With the reclassification of the U.S. senior care and related operations, and VCPI to discontinued operations, and the recent expansion into the private-pay retirement sector, the Company reports the following segments within its Canadian operations: i) long-term care; ii) retirement living; iii) home health care; and iv) management and group purchasing as "other Canadian operations"; and v) the Canadian corporate functions and any intersegment eliminations as "corporate Canada". The Company continues to segment its U.S. operations as one segment, with the U.S. continuing operations consisting of its wholly owned Bermuda-based captive insurance company, Laurier Indemnity Company, Ltd. (the "Captive"), which, along with third-party insurers, insured Extendicare's U.S. general and professional liability risks up to the date of the U.S. Sale Transaction.

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

LONG-TERM CARE (including government-funded supportive living)

Through its subsidiaries, Extendicare owns and operates for its own account 58 LTC centres with capacity for 8,116 residents, inclusive of a stand-alone designated supportive living centre (140 suites) and a designated supportive living wing (60 suites) in Alberta, and two retirement wings (76 suites) in Ontario. This reporting segment excludes the senior care centres that are managed by our management services group on behalf of third parties, as the revenue from those operations is earned on a fee-for-service basis (refer to the discussion below under the heading "Other Canadian Operations – Management Services"). Revenue from the long-term care operations represented 57.9% of consolidated revenue from continuing operations for the six months ended June 30, 2016, compared to 68.0% for the same 2015 period (2015 year – 63.0%). The change in the revenue mix during 2015 primarily resulted from the impact of growth in revenue outside of the long-term care segment due primarily to the acquisition of a home health business in April 2015 (the "Home Health Acquisition".

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

In Ontario, operators have the opportunity to receive additional funding through higher accommodation rates charged to residents for private and semi-private accommodation, at maximum preferred accommodation rates that are fixed by the government. Operators are permitted to designate up to 60% of the resident capacity of a centre as preferred accommodation at higher fixed rates that vary according to the structural classification of the LTC centre. In Ontario, Extendicare operates 13 “New” centres (1,847 beds), built since 1998 under the 1999 design standards, and 21 “C” centres (3,287 beds), built prior to 1998 that meet the 1972 design standards.

The following summarizes the composition of the owned/leased LTC centres operated by Extendicare in Ontario, as at June 30, 2016.

		Composition of Beds				
Ontario Owned/Leased	**No. of Centres**	**Private up to $25.00 premium**	**Private $18.00 premium**	**Semi-private $8.00 premium**	**Basic/Other**	**Total**
“New”	13	1,099	–	–	748	1,847
“C”	21	–	476	1,400	1,411	3,287
	34	1,099	476	1,400	2,159	5,134

RETIREMENT LIVING

Through its subsidiaries, Extendicare owns and operates six retirement communities with capacity for 506 residents, all of which were newly acquired since October 2015, and are operated under our Esprit Lifestyle Communities brand. Four of these retirement communities (342 suites) are located in Saskatchewan and two (164 suites) are located in Ontario. In addition, we have four (424 suites) under development in Ontario.

These retirement communities provide services to private-pay residents at rates set by Extendicare based on the services provided and market conditions. The monthly fees vary depending on the type of accommodation, level of care and services chosen by the resident, and sometimes on the location of the retirement community. Residents are free to choose the living arrangements best suited to their personal preference and needs and, more importantly, change the level of care and support they receive as their needs evolve over time. Revenue from these operations represented 1.4% of consolidated revenue from continuing operations for the six months ended June 30, 2016 (2015 year – 0.1%).

HOME HEALTH CARE

Extendicare provides home health care services through its ParaMed division. ParaMed’s professionals and staff members are skilled in providing complex nursing care, occupational, physical and speech therapy, and assistance with daily activities to accommodate clients of all ages living at home. Revenue from these operations represented 38.7% of consolidated revenue from continuing operations for the six months ended June 30, 2016, compared to 30.1% for the same 2015 period (2015 year – 34.7%). The Home Health Acquisition contributed revenue of approximately $98.6 million for the six months ended June 30, 2016 (first half of 2015 – $33.5 million; 2015 year – $131.6 million).

Provincial governments fund a wide range of home health care services, and contract these services to providers such as ParaMed. In the first six months of 2016, ParaMed received approximately 97% of its revenue from contracts tendered by locally administered provincial agencies (2015 year – 97%), with the remainder from private-pay clients. At the time of the Home Health Acquisition in April 2015, ParaMed’s operations were solely in Ontario, where it provided approximately 5.1 million hours of service annually, making it the largest provider of publicly funded home health care in Ontario. Following the Home Health Acquisition, ParaMed’s operations more than doubled and expanded to six provinces. In the first six months of 2016, ParaMed’s service volumes were 5.3 million, of which Ontario represented approximately 85%, followed by British Columbia at 9%, Alberta at 4%, and the balance provided in Manitoba, Quebec and Nova Scotia. For the 2015 year, ParaMed provided approximately 8.9 million hours of service, of which the Home Health Acquisition contributed approximately 3.7 million for the eight months following the acquisition.

OTHER CANADIAN OPERATIONS

Extendicare's other Canadian operations are composed of its management and group purchasing services. Revenue from these operations represented 1.8% of consolidated revenue from continuing operations for the six months ended June 30, 2016 (2015 year – 1.6%).

Management Services

Through its Extendicare Assist division, Extendicare has leveraged its expertise in operating senior care centres by providing a wide range of management and consulting services to third-party owners. Extendicare Assist partners with not-for-profit and for-profit organizations, hospitals and municipalities that seek to improve their management practices, levels of care and operating efficiencies. Most of these contracts include management, accounting and purchasing services, staff training, reimbursement assistance, and where applicable, the implementation of Extendicare's policies and procedures. As a skilled manager and operator of senior care centres for third parties, Extendicare Assist's managed portfolio consisted of 54 senior care centres with capacity for 6,426 residents as at June 30, 2016 (no change from December 31, 2015).

Group Purchasing Services

Through its SGP Purchasing Partner Network division (SGP), Extendicare offers cost-effective purchasing contracts to other senior care providers for food, capital equipment, furnishings, cleaning and nursing supplies, and office products. SGP negotiates long-term contracts that insulate members from rising costs, thereby providing a cost-effective way to secure quality national brand-name products, along with a range of innovative services. As at June 30, 2016, SGP provided services to third-party clients with capacity for approximately 40,400 residents (December 31, 2015 – 29,600).

U.S. CONTINUING OPERATIONS

Following the closing of the U.S. Sale Transaction, Extendicare retained its wholly owned subsidiaries, VCPI and the Captive. In the 2016 second quarter, VCPI's operations were reclassified as discontinued, following the Board's decision to dispose of them.

Captive Insurance Company

Prior to the U.S. Sale Transaction, Extendicare self-insured certain risks related to general and professional liability of its disposed U.S. operations through the Captive. With the classification of the U.S. senior care operations as discontinued, the expense for self-insured liabilities incurred by the Captive has also been reclassified to discontinued operations. However, the obligation to settle any claims incurred prior to the closing of the U.S. Sale Transaction, including claims incurred but yet to be reported, remains with Extendicare through the Captive. The majority of the risks that Extendicare self-insured relating to the U.S. operations, are long-term in nature, and accordingly, claim payments for any particular policy year can occur over a long period of time. In addition, through the Captive, the Company maintained third-party liability insurance on a "claims made" basis, as opposed to "occurrence based" coverage, meaning that some level of coverage may continue to be required. The costs to administer and manage the settlement of the claims have not been classified as discontinued and are included in the continuing administrative costs of the U.S. operations.

As at June 30, 2016, the accrual for U.S. self-insured general and professional liabilities was $116.1 million (US$89.9 million) compared to US$107.2 million at the beginning of the year, and the investments held for U.S. self-insured liabilities totalled $150.6 million (US$116.6 million) compared to US$127.7 million at the beginning of the year, with the decline in each reflecting the "run off" of these operations. In the 2016 second quarter, the Company released US$3.1 million of reserves for self-insured liabilities following the completion of an interim independent actuarial review. In addition, subsequent to June 30, 2016, the Company released US$5.0 million of the Captive's funds held for investment to be available as cash for operations. The provisions recorded for our professional liability risks are based upon management's best available information, including actuarial estimates. The Captive is currently appropriately capitalized, but there can be no assurance that it will remain appropriately capitalized in the future should claims incurred prior to the closing of the U.S. Sale Transaction, including claims incurred but yet to be reported, increase significantly. For further information on our self-insured liabilities, refer to the discussion under the heading "Accrual for U.S. Self-insured Liabilities" found within the "Liquidity and Capital Resources" section of this MD&A.

KEY PERFORMANCE INDICATORS

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

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

"Average Daily Revenue Rate", or "ADRR" means the aggregate revenue earned divided by the aggregate census in the corresponding period, by payor source;

"Census" is defined as the number of residents occupying beds (or the number of occupied suites in the case of a retirement community) over a period of time;

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

"Non same-store" or "NSS", in the context of comparing our 2016 and 2015 results from continuing operations in this document, refers to the Home Health Acquisition that was completed on April 30, 2015, and the Retirement Acquisitions completed in the 2015 fourth quarter and the 2016 first quarter;

"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 suites in the case of a retirement community) available for occupancy multiplied by the number of days in the period; and

"Same-store" or "SS", in the context of comparing our 2016 and 2015 results from continuing operations in this document, refers to those centres and businesses that were operated by us on January 1, 2015, and throughout 2015 and 2016, and are not classified as held for sale; such operations specifically refer to all continuing operations excluding the Home Health Acquisition and the Retirement Acquisitions.

Long-term Care

Funding received by Extendicare for its long-term care centres 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 Extendicare. For more information on government funding in Canada, including recent developments and their impact or expected impact on Extendicare, refer to the discussion under the heading "Update of Regulatory and Funding Changes Affecting Results".

Revenue from provincial programs represents approximately 70% of Extendicare's long-term care centre revenue. In the 2016 second quarter, Extendicare's average daily revenue rate increased by 1.7% to $202.80 from $199.40 in the 2015 second quarter, and increased by 0.5% from $201.71 in the 2016 first quarter. The majority of Extendicare's long-term care operations are in Ontario, which operates under a funding envelope system, wherein a substantial portion of the revenue is tied to flow-through funding that is only recognized in the periods in which the related costs for resident care are incurred. Many of our centres are in an "underspent" position at the start of the year, resulting in a deferral of flow-through funding until it is matched with increased spending throughout the year. As a result, absent the impact of funding changes throughout the year, Extendicare's average revenue rates are generally at their lowest in the first quarter, when funding has been deferred, and at their highest in the fourth quarter, when previously deferred funding has been recognized. For the 2015 year, Extendicare's average daily revenue rate increased by 1.5% to $201.04 from $198.03 in 2014.

Extendicare's average occupancy was 97.9% this quarter compared to 98.0% in the 2015 second quarter and 98.0% in the 2016 first 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 could lead to temporary freezes on admissions.

In Ontario, overall funding is occupancy-based, but once the average occupancy level of 97% or higher for the calendar year is achieved, operators receive funding based on 100% occupancy. For the 2015 year, all of Extendicare's LTC centres in Ontario achieved the 97% occupancy threshold, with an overall average of 98.2%.

In addition, Extendicare's Ontario LTC centres receive premiums for preferred accommodation. The average occupancy of our private beds in our "New" centres improved to 96.8% this quarter from 93.5% in the 2015 second quarter, and from 96.4% in the 2016 first quarter. This improvement was primarily due to the continued improvement in occupancy mix at our new northern Ontario centres that opened in 2013. The average occupancy of the private beds at our "C" centres improved to 99.2% this quarter from 97.7% in the 2015 second quarter, and from 99.1% in the 2016 first quarter.

The following table provides Extendicare's average daily revenue rates and occupancy levels from its LTC operations for the past eight quarters.

	2016		2015				2014	
Long-term Care Centres	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**
Average Daily Revenue Rate *($)*	**202.80**	**201.71**	205.60	200.76	199.40	198.31	204.14	197.17
Average Occupancy *(%)*								
Total LTC	**97.9%**	**98.0%**	98.1%	98.2%	98.0%	97.4%	98.2%	98.2%
Ontario LTC								
Total operations	**98.5%**	**98.5%**	98.5%	98.5%	98.3%	97.4%	98.4%	98.4%
Preferred Accommodation (1)								
"New" centres – private	**96.8%**	**96.4%**	95.4%	94.8%	93.5%	91.3%	91.4%	89.7%
"C" centres – private	**99.2%**	**99.1%**	98.8%	98.7%	97.7%	97.4%	98.5%	98.2%
"C" centres – semi-private	**64.3%**	**63.5%**	63.6%	62.5%	60.6%	60.6%	61.0%	60.4%

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

Retirement Living

With respect to the four retirement communities acquired in 2015, the average occupancy for the six months ended June 30, 2016, was 70.4%, and has improved to 76.7% as at July 29, 2016. In February 2016, the Company acquired two newly built retirement communities. The average occupancy of all six retirement communities for the six months ended June 2016, was 56.3%, and has improved to 60.1% as at July 29, 2016. The average monthly revenue per occupied room was $4,573 for the six months ended June 30, 2016, and was $4,674 in the 2016 second quarter.

Home Health Care

Revenue from provincial programs represented approximately 97% of Extendicare's home health care revenue for the six months ended June 30, 2016 (2015 year – 97%). On a same-store basis, ParaMed's service volumes increased by 2.1% this quarter over the same 2015 period. ParaMed's total average daily hours of service this quarter increased by 1.6% to 29,301 from 28,847 in the 2016 first quarter. For the 2015 year, ParaMed's same-store service volumes increased by 0.3% over 2014, and with the Home Health Acquisition, the average daily hours of service more than doubled to 29,310 from 13,925 in 2014. For further information on the home health care operations, refer to the discussion under the heading "Update of Regulatory and Funding Changes Affecting Results –Ontario Home Health Care Legislation and Funding".

The following table provides Extendicare's home health care service volumes for the past eight quarters.

Home Health Care	2016		2015				2014	
Service Volumes	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**
Total Operations								
Hours of service (000's)	**2,666.4**	**2,625.1**	2,689.2	2,692.9	2,252.4	1,238.2	1,283.4	1,303.8
Hours per day	**29,302**	**28,847**	29,230	29,271	29,951	13,758	13,950	14,172
Same-store Basis								
Hours of service (000's)	**1,317.5**	**1,294.0**	1,332.1	1,285.0	1,290.3	1,238.2	1,283.4	1,303.8
Hours per day	**14,478**	**14,220**	14,480	13,967	14,179	13,758	13,950	14,172

IMPACT OF U.S. DOLLAR AND FOREIGN CURRENCY TRANSLATION

Impact on Financial Statements

Our remaining U.S. net assets accounted for approximately: 25% of our consolidated assets as at June 30, 2016 (December 31, 2015 – 29%); and 16% of our consolidated liabilities as at June 30, 2016 (December 31, 2015 – 24%). The impact of a one-cent weakening (strengthening) of the Canadian dollar against the U.S. dollar would have increased (decreased) our total assets and total liabilities as at June 30, 2016, by approximately $1.9 million and $1.2 million, respectively, for a net increase (decrease) of $0.7 million, of which approximately $0.5 million would increase (decrease) net earnings, and approximately $0.2 million would increase (decrease) other comprehensive income. For further information on currency risk, refer to *note 19* of the unaudited interim condensed consolidated financial statements.

The operating results of our U.S. operating segment in Canadian dollars were affected by fluctuations in foreign exchange rates. For the first six months of 2016, our remaining U.S. continuing operations accounted for: less than 1% of our revenue from continuing operations; 2% of net operating income (2015 year – 4%); and 8% of AFFO from continuing operations (2015 year – less than 1%).

The exchange rates used in translating our U.S. operations were as follows:

	Three months ended June 30			Six months ended June 30			Year		
U.S./Canadian Exchange Rates	**2016**	**2015**	**Increase/ (Decrease)**	**2016**	**2015**	**Increase/ (Decrease)**	**2015**	**2014**	**Increase/ (Decrease)**
Average exchange rate	**1.2873**	1.2297	**0.0576**	**1.3302**	1.2354	**0.0948**	1.2787	1.1045	0.1742
Period end exchange rate				**1.2917**		**(0.0923)**	1.3840		

The impact of the weaker Canadian dollar in the first six months of 2016 compared to the same 2015 period favourably impacted our revenue and net operating income from continuing operations by $0.1 million (2015 year – $0.7 million), and our AFFO from continuing operations by $0.2 million (2015 year – nil).

In addition, as a result of U.S. net proceeds and deferred consideration received in respect of the U.S. Sale Transaction, our net earnings from continuing operations are impacted by fluctuations in foreign exchange rates. We recognized an unrealized foreign exchange loss of $0.8 million in the 2016 second quarter, and $4.7 million in the first six months of 2016, as a result of the stronger Canadian dollar of 1.2917 at June 30, 2016, compared to 1.3840 at December 31, 2015.

DIVIDEND POLICY

The declaration and payment of dividends by Extendicare is at the discretion of the Board as to the amount and timing of dividends to be declared and paid, after consideration of a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of Extendicare, debt covenants and obligations, and any other factors deemed relevant by the Board. If 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.

Dividends declared in the first six months of 2016 totalled $21.2 million, or $0.24 per share, representing a payout ratio of approximately 67% of AFFO of $31.4 million, or $0.356 per basic share, compared to a payout ratio of approximately 76% in the same 2015 period. For the 2015 year, dividends declared totalled $42.1 million, or $0.48 per share, representing a payout ratio of approximately 83% of AFFO of $50.8 million, or $0.579 per basic share.

Taxability of Dividends

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".

2016 SELECTED QUARTERLY INFORMATION

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

	2016		2015				2014	
(thousands of dollars unless otherwise noted)	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**
Revenue	**261,425**	**254,383**	262,590	253,556	234,358	192,775	204,486	199,913
Net operating income	**34,747**	**26,595**	32,830	32,456	31,139	23,365	27,183	26,750
Net operating income margin	***13.3%***	***10.5%***	*12.5%*	*12.8%*	*13.3%*	*12.1%*	*13.3%*	*13.4%*
Adjusted EBITDA	**26,647**	**16,517**	23,012	22,938	22,384	15,357	22,173	18,714
Adjusted EBITDA margin	***10.2%***	***6.5%***	*8.8%*	*9.0%*	*9.6%*	*8.0%*	*10.8%*	*9.4%*
Earnings (loss) from continuing operations	**9,695**	**(1,483)**	7,266	11,209	3,978	1,257	7,912	3,072
Gain on sale of U.S. operations, net of taxes	–	–	749	204,669	–	–	–	–
Earnings (loss) from discontinued operations	**(4,947)**	**(1,765)**	2,530	418	(5,496)	5,498	1,296	(9,083)
Net earnings (loss)	**4,748**	**(3,248)**	10,545	216,296	(1,518)	6,755	9,208	(6,011)
AFFO (continuing operations)	**20,012**	**12,344**	10,420	15,027	11,840	6,300	10,320	8,736
per basic share *($)*	**0.227**	**0.140**	0.119	0.171	0.135	0.072	0.117	0.100
AFFO	**19,155**	**12,235**	9,611	13,540	5,834	21,843	19,417	17,272
per basic share *($)*	**0.217**	**0.139**	0.109	0.155	0.067	0.248	0.221	0.196
Maintenance Capex								
Continuing operations	**2,835**	**1,040**	6,713	3,423	2,295	815	5,806	2,842
Discontinued operations	**232**	**110**	780	763	5,345	2,544	4,093	4,023
Cash dividends declared	**10,595**	**10,571**	10,547	10,522	10,510	10,546	10,573	10,547
per share *($)*	**0.120**	**0.120**	0.120	0.120	0.120	0.120	0.120	0.120
Weighted Average Number of Shares								
Basic	**88,269**	**88,057**	87,852	87,663	87,557	88,003	88,066	87,854
Diluted	**99,513**	**99,302**	99,097	98,907	98,802	99,247	99,311	99,099
U.S./Canadian dollar average exchange rate for the period	**1.2873**	**1.3731**	1.3342	1.3084	1.2297	1.2412	1.1351	1.0891

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

	2016		2015				2014	
(thousands of dollars)	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**
Earnings (loss) from continuing operations before income taxes	**13,597**	**(1,556)**	10,819	18,222	6,062	2,447	9,855	4,771
Add (Deduct):								
Depreciation and amortization	**7,753**	**7,147**	6,835	6,103	5,830	4,900	5,797	4,876
Net finance costs (income)	**5,092**	**8,790**	1,944	(2,189)	8,902	7,111	7,147	7,143
Other expense (income)	**205**	**2,136**	3,414	802	1,590	899	(626)	1,924
Adjusted EBITDA	**26,647**	**16,517**	23,012	22,938	22,384	15,357	22,173	18,714
Add (Deduct):								
Administrative costs	**6,458**	**8,407**	8,136	7,891	7,247	6,870	3,916	6,947
Lease costs	**1,642**	**1,671**	1,682	1,627	1,508	1,138	1,094	1,089
Net operating income	**34,747**	**26,595**	32,830	32,456	31,139	23,365	27,183	26,750

There are a number of factors affecting the trend of our quarterly results from continuing operations. For seasonal trends, while year-over-year quarterly comparisons will generally remain appropriate, sequential quarters can vary materially. We already report as separate line items, “loss (gain) on foreign exchange and financial instruments” and “other expense (income)”, 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:

- Ontario long-term care funding tied to flow-through envelopes requires revenue be deferred until it is matched with the related costs for resident care in the periods in which the costs are incurred, resulting in a fluctuation in revenue and operating expenses by quarter, and they are generally at their lowest in the first quarter and at their highest in the fourth quarter;
- Ontario long-term care providers generally receive annual flow-through funding increases and CMI adjustments effective April 1st and accommodation funding increases effective July 1st, and Alberta long-term care providers generally receive annual inflationary rate increases and acuity-based funding adjustments on April 1st, and accommodation funding increases effective July 1st;
- maintenance capex spending, which impacts our AFFO, fluctuates on a quarterly basis with the timing of projects and seasonality, and is generally at its lowest in the first quarter and its highest in the fourth quarter;
- utility costs are generally at their highest in the first quarter and their lowest in the second and third quarters, and can vary by as much as $1.5 million to $2.0 million; 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; for example, as a result of U.S. net proceeds and deferred consideration received in respect of the disposal or our U.S. operations in July 2015, our earnings from continuing operations were unfavourably impacted by net foreign exchange losses of $3.9 million and $0.8 million in the 2016 first quarter and 2016 second quarter, respectively, and were favourably impacted by net foreign exchange gains of $6.5 million and $3.3 million in the 2015 third and fourth quarters, respectively.

Further details on the above can be found under the sections “Significant 2016 Events and Developments”, “Key Performance Indicators”, “Impact of U.S. Dollar and Foreign Currency Translation”, “Other Significant Developments” and “Update of Regulatory and Funding Changes Affecting Results”.

ADJUSTED FUNDS FROM OPERATIONS

The following table provides a reconciliation of our “Adjusted EBITDA” to “FFO” and “AFFO”.

	Three months ended June 30			Six months ended June 30		
(thousands of dollars unless otherwise noted)	**2016**	**2015**	**Change**	**2016**	**2015**	**Change**
Adjusted EBITDA	**26,647**	22,384	4,263	**43,164**	37,741	5,423
Depreciation for FFEC (maintenance capex) (1)	**(1,913)**	(1,666)	(247)	**(3,733)**	(3,180)	(553)
Accretion costs	**(616)**	(604)	(12)	**(1,253)**	(1,208)	(45)
Interest expense	**(6,306)**	(9,035)	2,729	**(13,266)**	(16,390)	3,124
Interest revenue	**2,631**	737	1,894	**5,393**	1,585	3,808
	20,443	11,816	8,627	**30,305**	18,548	11,757
Current income tax expense (2)	**3,560**	2,833	727	**6,418**	5,988	430
FFO (continuing operations)	**16,883**	8,983	7,900	**23,887**	12,560	11,327
Amortization of financing costs	**426**	1,818	(1,392)	**794**	2,174	(1,380)
Accretion costs	**616**	604	12	**1,253**	1,208	45
Non-cash share-based compensation	**396**	−	396	**396**	−	396
Principal portion of government capital funding	**1,189**	1,064	125	**3,301**	2,128	1,173
Income support (retirement acquisitions)	**1,891**	−	1,891	**3,096**	−	3,096
Amounts offset through investments held for self-insured liabilities (3)	**(467)**	−	(467)	**(229)**	−	(229)
Additional maintenance capex (1)	**(922)**	(629)	(293)	**(142)**	70	(212)
AFFO (continuing operations)	**20,012**	11,840	8,172	**32,356**	18,140	14,216
Discontinued operations	**(857)**	(6,006)	5,149	**(966)**	9,537	(10,503)
AFFO (4)	**19,155**	5,834	13,321	**31,390**	27,677	3,713
Per Basic Share *($)*						
FFO (continuing operations)	**0.191**	0.102	0.089	**0.271**	0.143	0.128
FFO	**0.176**	0.076	0.100	**0.246**	0.301	(0.055)
AFFO (continuing operations)	**0.227**	0.135	0.092	**0.367**	0.207	0.160
AFFO	**0.217**	0.067	0.150	**0.356**	0.315	0.041
Per Diluted Share *($)*						
FFO (continuing operations)	**0.191**	0.102	0.089	**0.271**	0.143	0.128
FFO	**0.176**	0.084	0.092	**0.246**	0.301	(0.055)
AFFO (continuing operations)	**0.214**	0.135	0.079	**0.352**	0.207	0.145
AFFO	**0.206**	0.073	0.133	**0.343**	0.307	0.036
Dividends *($)*						
Declared	**10,595**	10,510	85	**21,166**	21,056	110
Declared per share *($)*	**0.120**	0.120	−	**0.240**	0.240	−
Weighted Average Number of Shares *(thousands)*						
Basic	**88,269**	87,557		**88,163**	87,779	
Diluted	**99,513**	98,802		**99,408**	99,023	

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

(2) Excludes current income tax with respect to items that are excluded from the computation of AFFO from continuing operations, such as the gains or losses on foreign exchange, financial instruments, asset impairment, disposals and other expense (income), and provisions for prior period tax reassessments.

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

(4) Refer to the reconciliation of “AFFO” to “net cash from operating activities” provided within this section under the heading “Reconciliation of Net Cash from Operating Activities to AFFO”.

AFFO 2016 Second Quarter Financial Review

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

							Three months ended June 30
			2016			2015	Total
(thousands of dollars unless otherwise noted)	Canada	U.S.	Total	Canada	U.S.	Total	Change
AFFO (continuing operations)	**18,650**	**1,362**	**20,012**	13,292	(1,452)	11,840	8,172
Discontinued operations	**–**	**(857)**	**(857)**	–	(6,006)	(6,006)	5,149
AFFO	**18,650**	**505**	**19,155**	13,292	(7,458)	5,834	13,321
Maintenance capex (continuing operations)	**2,835**	**–**	**2,835**	2,295	–	2,295	540
Discontinued operations	**–**	**232**	**232**	–	5,345	5,345	(5,113)
Maintenance capex	**2,835**	**232**	**3,067**	2,295	5,345	7,640	(4,573)
Average U.S./Canadian dollar exchange rate			**1.2873**			1.2297	

AFFO was $19.1 million ($0.217 per basic share) in the 2016 second quarter compared to $5.8 million ($0.067 per basic share) in the 2015 second quarter, representing an increase of $13.3 million, due to an improvement in AFFO from continuing operations of $8.2 million, and a reduction in losses from discontinued operations.

AFFO from continuing operations was $20.0 million ($0.227 per basic share) this quarter compared to $11.8 million ($0.135 per basic share) in the 2015 second quarter. The $8.2 million improvement in AFFO from continuing operations included an improvement in Adjusted EBITDA of $4.2 million, income support on the retirement acquisitions of $1.9 million, and lower net finance costs of $3.2 million, partially offset by an increase in maintenance capex of $0.5 million and current income taxes of $0.7 million. Net finance costs included $1.8 million (US$1.4 million) of interest revenue realized this quarter in connection with deferred consideration from the U.S. Sale Transaction. A discussion of the factors impacting Adjusted EBITDA from continuing operations and net finance costs can be found under the heading "2016 Second Quarter Financial Review".

Maintenance capex from continuing operations was $2.8 million this quarter, compared to $2.3 million in the 2015 second quarter and to $1.0 million in the 2016 first quarter, representing 1.1%, 1.0% and 0.4% of revenue from continuing operations, respectively.

AFFO 2016 Six Month Financial Review

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

							Six months ended June 30
			2016			2015	Total
(thousands of dollars unless otherwise noted)	Canada	U.S.	Total	Canada	U.S.	Total	Change
AFFO (continuing operations)	**29,805**	**2,551**	**32,356**	21,170	(3,030)	18,140	14,216
Discontinued operations	**–**	**(966)**	**(966)**	–	9,537	9,537	(10,503)
AFFO	**29,805**	**1,585**	**31,390**	21,170	6,507	27,677	3,713
Maintenance capex (continuing operations)	**3,875**	**–**	**3,875**	3,110	–	3,110	765
Discontinued operations	**–**	**342**	**342**	–	7,889	7,889	(7,547)
Maintenance capex	**3,875**	**342**	**4,217**	3,110	7,889	10,999	(6,782)
Average U.S./Canadian dollar exchange rate			**1.3302**			1.2354	

AFFO was $31.4 million ($0.356 per basic share) in the first six months of 2016 compared to $27.7 million ($0.315 per basic share) in the same 2015 period, representing an increase of $3.7 million, due to a $14.2 million improvement in AFFO from continuing operations, partially offset by a reduction in AFFO from discontinued operations of $10.5 million as a result of the completion of the U.S. Sale Transaction.

AFFO from continuing operations was $32.3 million ($0.367 per basic share) this period compared to $18.1 million ($0.207 per basic share) in the first six months of 2015. The $14.2 million improvement in AFFO from continuing operations included an improvement in Adjusted EBITDA of $5.4 million, income support on the retirement acquisitions of $3.1 million, lower net finance costs of $5.5 million, and an increase in government capital funding of $1.2 million that included $1.0 million of retroactive funding on two redeveloped long-term care centres, partially offset by higher maintenance capex of $0.8 million and current income taxes of $0.4 million. Net finance costs included $3.8 million (US$2.8 million) of interest revenue realized this period in connection with deferred consideration from the U.S. Sale

Transaction. A discussion of the factors impacting Adjusted EBITDA from continuing operations and net finance costs can be found under the heading "2016 Six Month Financial Review".

Current income taxes impacting AFFO for the first six months of 2016 were $6.4 million compared to $6.0 million in the same 2015 period, representing 21.2% and 32.3% of pre-tax FFO from continuing operations, respectively, with the variance in effective rates primarily due to the impact of deferred timing difference and the proportion of earnings between taxable and non-taxable entities.

The determination of FFO includes a deduction for current income tax expense, and does not include deferred income tax expense. As a result, the effective tax rates on our FFO can be impacted by: adjustments to our estimates of annual deferred 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; cross-border dividends; and the ability to utilize loss carryforwards. The effective tax rate on FFO for the first six months of 2016 at 21.2% was within the anticipated range for the 2016 year of between 20% and 25%.

Maintenance capex from continuing operations was $3.9 million this period, compared to $3.1 million in the first six months of 2015, representing 0.8% and 0.7% of revenue from continuing operations, respectively. For the 2015 year, maintenance capex from continuing operations was $13.2 million, representing 1.4% of revenue from continuing operations. These costs fluctuate on a quarterly basis with the timing of projects and seasonality. It is our intention to spend approximately 1.5% of revenue annually in maintenance capex, which is consistent with our objective to maintain and upgrade our centres. In 2016, we are expecting to spend in the range of $13 million to $16 million in maintenance capex and in the range of $35 million to $40 million in growth capex, related primarily to the retirement development projects.

Reconciliation of Net Cash from Operating Activities to AFFO

The following table provides a reconciliation of the "net cash from operating activities" to "AFFO".

	Three months ended June 30		**Six months ended June 30**	
(thousands of dollars)	**2016**	**2015**	**2016**	**2015**
Net cash from operating activities	**7,840**	26,946	**(13,071)**	48,017
Add (Deduct):				
Net change in operating assets and liabilities, including interest, taxes and payments for U.S. self-insured liabilities	**3,552**	8,725	**34,989**	14,923
Current income tax on items excluded from AFFO [(1)]	**8,217**	5,442	**7,521**	2,879
Depreciation for FFEC (maintenance capex) [(2)]	**(2,676)**	(2,498)	**(5,347)**	(4,914)
Additional maintenance capex [(2)]	**(391)**	(5,142)	**1,130**	(6,085)
Principal portion of government capital funding	**1,189**	1,064	**3,301**	2,128
Income support (retirement acquisitions)	**1,891**	−	**3,096**	−
Amounts offset through investments held for self-insured liabilities [(3)]	**(467)**	−	**(229)**	−
Expense for U.S. self-insured liabilities	−	(25,649)	−	(34,495)
U.S. property taxes under IFRIC 21	−	(3,069)	−	5,209
Other	−	15	−	15
AFFO	**19,155**	5,834	**31,390**	27,677

(1) Represents current income tax with respect to items that are excluded from the computation of AFFO, such as the gain on sale of the U.S. operations, the provision for U.S. government investigations, property taxes accounted for under IFRIC 21, gains or losses on foreign exchange, financial instruments, asset impairment, disposals and other expense (income), and provisions for prior period tax reassessments.

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

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

2016 SECOND QUARTER FINANCIAL REVIEW

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

	Three months ended June 30						
			2016			**2015**	**Total**
(thousands of dollars)	**Canada**	**U.S.**	**Total**	**Canada**	**U.S.**	**Total**	**Change**
Revenue	**260,455**	**970**	**261,425**	234,131	227	234,358	27,067
Operating expenses	**226,678**	**–**	**226,678**	203,219	–	203,219	23,459
Net operating income	**33,777**	**970**	**34,747**	30,912	227	31,139	3,608
Administrative costs	**5,969**	**489**	**6,458**	5,508	1,739	7,247	(789)
Lease costs	**1,642**	**–**	**1,642**	1,508	–	1,508	134
Adjusted EBITDA	**26,166**	**481**	**26,647**	23,896	(1,512)	22,384	4,263
Depreciation and amortization	**7,753**	**–**	**7,753**	5,830	–	5,830	1,923
Other expense	**205**	**–**	**205**	1,590	–	1,590	(1,385)
Earnings (loss) before net finance costs and income taxes	**18,208**	**481**	**18,689**	16,476	(1,512)	14,964	3,725
Interest expense (net of capitalized interest)	**6,306**	**–**	**6,306**	9,035	–	9,035	(2,729)
Interest revenue	**(785)**	**(1,846)**	**(2,631)**	(737)	–	(737)	(1,894)
Accretion	**294**	**322**	**616**	279	325	604	12
Loss (gain) on foreign exchange	**586**	**215**	**801**	–	–	–	801
Net finance costs	**6,401**	**(1,309)**	**5,092**	8,577	325	8,902	(3,810)
Earnings (loss) from continuing operations before income taxes	**11,807**	**1,790**	**13,597**	7,899	(1,837)	6,062	7,535
Income tax expense (recovery)							
Current	**3,062**	**498**	**3,560**	2,705	(60)	2,645	915
Deferred	**(24)**	**366**	**342**	(561)	–	(561)	903
Total income tax expense (recovery)	**3,038**	**864**	**3,902**	2,144	(60)	2,084	1,818
Earnings (loss) from continuing operations	**8,769**	**926**	**9,695**	5,755	(1,777)	3,978	5,717
Earnings (loss) from discontinued operations	**–**	**(4,947)**	**(4,947)**	–	(5,496)	(5,496)	549
Net earnings (loss)	**8,769**	**(4,021)**	**4,748**	5,755	(7,273)	(1,518)	6,266
Earnings (loss) from continuing operations	**8,769**	**926**	**9,695**	5,755	(1,777)	3,978	5,717
Add (Deduct) (1):							
Loss (gain) on foreign exchange	**513**	**158**	**671**	–	–	–	671
Other expense	**151**	**–**	**151**	1,226	–	1,226	(1,075)
Earnings (loss) from continuing operations before separately reported items, net of taxes	**9,433**	**1,084**	**10,517**	6,981	(1,777)	5,204	5,313

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

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

	Three months ended June 30						
			2016			**2015**	**Total**
(thousands of dollars)	**Canada**	**U.S.**	**Total**	**Canada**	**U.S.**	**Total**	**Change**
Earnings (loss) from continuing operations before income taxes	**11,807**	**1,790**	**13,597**	7,899	(1,837)	6,062	7,535
Add (Deduct):							
Depreciation and amortization	**7,753**	**–**	**7,753**	5,830	–	5,830	1,923
Net finance costs	**6,401**	**(1,309)**	**5,092**	8,577	325	8,902	(3,810)
Other expense	**205**	**–**	**205**	1,590	–	1,590	(1,385)
Adjusted EBITDA	**26,166**	**481**	**26,647**	23,896	(1,512)	22,384	4,263
Add (Deduct):							
Administrative costs	**5,969**	**489**	**6,458**	5,508	1,739	7,247	(789)
Lease costs	**1,642**	**–**	**1,642**	1,508	–	1,508	134
Net operating income	**33,777**	**970**	**34,747**	30,912	227	31,139	3,608

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

Three months ended June 30 *(thousands of dollars)*	**Long-term Care**	**Retirement Living**	**Home Health Care**	**Other Canadian Operations**	**Corporate Canada**	**Total Canada**	**Total U.S.**	**Total**
2016 – Same-store								
Revenue	**149,960**	–	**51,408**	**4,853**	**4**	**206,225**	**970**	**207,195**
Operating expenses	**130,022**	–	**45,373**	**2,177**	–	**177,572**	–	**177,572**
Net operating income	**19,938**	–	**6,035**	**2,676**	**4**	**28,653**	**970**	**29,623**
Net operating income margin (%)	***13.3%***	–	***11.7%***	***55.1%***	***100.0%***	***13.9%***	***100.0%***	***14.3%***
2016 – Non Same-store								
Revenue	–	**3,687**	**50,543**	–	–	**54,230**	–	**54,230**
Operating expenses	–	**3,668**	**45,438**	–	–	**49,106**	–	**49,106**
Net operating income	–	**19**	**5,105**	–	–	**5,124**	–	**5,124**
Net operating income margin (%)	–	***0.5%***	***10.1%***	–	–	***9.4%***	–	***9.4%***
2016 – Total								
Revenue	**149,960**	**3,687**	**101,951**	**4,853**	**4**	**260,455**	**970**	**261,425**
Operating expenses	**130,022**	**3,668**	**90,811**	**2,177**	–	**226,678**	–	**226,678**
Net operating income	**19,938**	**19**	**11,140**	**2,676**	**4**	**33,777**	**970**	**34,747**
Net operating income margin (%)	***13.3%***	***0.5%***	***10.9%***	***55.1%***	***100.0%***	***13.0%***	***100.0%***	***13.3%***
2015 – Same-store								
Revenue	146,808	–	49,627	4,183	23	200,641	227	200,868
Operating expenses	127,816	–	43,186	2,085	–	173,087	–	173,087
Net operating income	18,992	–	6,441	2,098	23	27,554	227	27,781
Net operating income margin (%)	*12.9%*	–	*13.0%*	*50.2%*	*100.0%*	*13.7%*	*100.0%*	*13.8%*
2015 – Non Same-store								
Revenue	–	–	33,490	–	–	33,490	–	33,490
Operating expenses	–	–	30,132	–	–	30,132	–	30,132
Net operating income	–	–	3,358	–	–	3,358	–	3,358
Net operating income margin (%)	–	–	*10.0%*	–	–	*10.0%*	–	*10.0%*
2015 – Total								
Revenue	146,808	–	83,117	4,183	23	234,131	227	234,358
Operating expenses	127,816	–	73,318	2,085	–	203,219	–	203,219
Net operating income	18,992	–	9,799	2,098	23	30,912	227	31,139
Net operating income margin (%)	*12.9%*	–	*11.8%*	*50.2%*	*100.0%*	*13.2%*	*100.0%*	*13.3%*
Change in Total								
Revenue	3,152	3,687	18,834	670	(19)	26,324	743	27,067
Operating expenses	2,206	3,668	17,493	92	–	23,459	–	23,459
Net operating income	946	19	1,341	578	(19)	2,865	743	3,608

Consolidated Revenue

Consolidated continuing operations – revenue grew by $27.1 million, or 11.5%, to $261.4 million in the 2016 second quarter, of which acquisitions contributed $20.7 million, with growth from same-store revenue of 3.1% over the same 2015 period.

Long-term care operations – revenue improved by $3.2 million, or 2.1%, to $150.0 million this quarter, primarily due to funding enhancements. Approximately $0.6 million of the increase in revenue related to our Ontario flow-through envelopes and was therefore directly offset by increased costs of resident care, and approximately $0.2 million was due to improvements in preferred accommodation. Our average occupancy was 97.9% this quarter compared to 98.0% in the 2015 second quarter, and our average daily revenue rate increased by 1.7% to $202.80 this quarter from $199.40 in the same 2015 period.

Retirement living operations – revenue from the Retirement Acquisitions completed since October 2015 was $3.7 million, with average occupancy of 52.4% and average monthly revenue per occupied room of $4,674 in the 2016 second quarter. In accordance with the purchase agreements, the purchase price of four of the communities that had been open for less than a year when acquired, includes income support to be released to Extendicare during the lease-up periods until the communities reach stabilized NOI. The realization of income support is not included in earnings reported in the consolidated statements of earnings, but it is included in the determination of AFFO. This quarter, the Company realized $1.9 million of income support in determining AFFO.

Home health care operations – revenue improved by $18.8 million, or 22.7%, to $101.9 million, of which $17.0 million was from the Home Health Acquisition. Same-store revenue grew by $1.8 million primarily due to enhanced funding to support an increase in government-funded wage increases for personal support workers (PSWs), estimated at approximately $1.0 million, and a 2.1% increase in daily hours of service provided to 14,478 this quarter from 14,179 in the 2015 second quarter. The average hourly service rate was $39.02 this quarter compared to $38.46 in the same 2015 period, and remained unchanged excluding the impact of the government funding for the PSW wage increases.

Other Canadian operations – revenue from our management and group purchasing operations improved by $0.7 million to $4.8 million in the 2016 second quarter, primarily due to growth in the number of clients served.

U.S. operations – revenue from the Captive improved by $0.7 million in the 2016 second quarter due to an increase in investment income.

Consolidated Operating Expenses

Consolidated continuing operations – operating expenses increased by $23.5 million, or 11.6%, to $226.7 million in the 2016 second quarter, primarily as a result of the acquisitions. The majority of our operating expenses are labour related, which increased by $21.8 million over the same 2015 period, and represented 87.0% and 86.4% of operating expenses in the second quarters of 2016 and 2015, respectively, and as a percentage of revenue were 75.5% and 74.9%, respectively. Acquisitions contributed approximately $18.9 million to the increase in operating expenses this quarter, with same-store operating expenses increasing by 2.6%, primarily due to higher labour costs.

Long-term care operations – operating expenses increased by $2.3 million to $130.1 million in the 2016 second quarter, which included higher labour costs of approximately $0.9 million, or 0.8%. Labour costs of our long-term care operations represented 83.7% and 84.5% of operating expenses in the second quarters of 2016 and 2015, respectively.

Retirement operations – operating expenses from the Retirement Acquisitions were $3.7 million, of which approximately $2.5 million, or 67.4%, were labour costs.

Home health care operations – operating expenses increased by $17.5 million to $90.8 million, of which $15.3 million was from the Home Health Acquisition. Same-store operating expenses grew by $2.2 million, of which approximately $1.0 million related to the government-funded wage increases, and the balance was largely due to labour costs to support the 2.1% increase in volumes. Labour costs of our home health care operations represented 92.9% and 89.9% of its operating expenses in the second quarters of 2016 and 2015, respectively.

Other Canadian operations – operating expenses from our management and group purchasing operations were unchanged at $2.1 million in each of the 2016 and 2015 second quarters.

Consolidated Net Operating Income

Consolidated net operating income from continuing operations improved by $3.6 million, or 11.6%, to $34.7 million in the 2016 second quarter compared to $31.1 million in the same 2015 period, representing 13.3% of revenue in each of the respective periods. As discussed above, revenue increased by $27.1 million and was partially offset by higher operating expenses of $23.5 million, which included a $21.8 million increase in labour costs. On a same-store basis, excluding the Home Health Acquisition and Retirement Acquisitions, net operating income improved by $1.8 million to $29.6 million, representing 14.3% of revenue this quarter compared to 13.8% in the same 2015 period. This improvement in same-store net operating income resulted from funding enhancements in our long-term care operations, higher preferred accommodation revenue, timing of recognition of funding to match costs under the Ontario envelope system, increased business volumes in our management services and group purchasing operations and higher investment income from our Captive, partially offset by unfunded cost increases in our home health care operations. Home health care funding increases from the Ontario government have been limited to a level to compensate operators to cover mandatory PSW wage increases. Management initiatives are under way with a specific focus to improve efficiency and reduce costs in our core home health care operations.

Administrative and Lease Costs

Administrative and lease costs decreased by $0.6 million to $8.1 million in the 2016 second quarter, due to a $1.2 million reduction in administrative costs to manage the run off of our U.S. self-insured liabilities, partially offset by a $0.6 million increase in the administrative and lease costs of our Canadian operations, of which approximately $0.2 million represented additional lease costs associated with the Home Health Acquisition

Consolidated Adjusted EBITDA

Consolidated Adjusted EBITDA improved to $26.6 million this quarter from $22.4 million in the same 2015 period, representing 10.2% and 9.6% of revenue, respectively. The improvement of $4.2 million, reflected growth in net operating income of $3.6 million and a reduction in administrative and lease costs, previously discussed.

Depreciation and Amortization

Depreciation and amortization costs increased by $1.9 million to $7.7 million this quarter, largely due to the acquisitions.

Other Expense

Extendicare recorded a pre-tax loss of $0.2 million in the 2016 second quarter related to integration and acquisition costs. In comparison, a pre-tax loss of $1.6 million was incurred in the 2015 second quarter related to acquisition costs.

Net Finance Costs (Income)

Net finance costs decreased by $3.8 million to $5.1 million this quarter, primarily due to lower interest expense of $2.7 million and higher interest revenue of $1.9 million, partially offset by a foreign exchange loss of $0.8 million. Interest expense in the 2015 second quarter included $2.2 million related to the bridge loan used to acquire the Home Care Acquisition and this quarter, $0.2 million of interest expense was capitalized in connection with construction projects. Interest revenue this quarter included $1.8 million (US$1.4 million) in connection with deferred consideration from the U.S. Sale Transaction.

Income Taxes

The income tax provision was $3.9 million on pre-tax earnings of $13.6 million this quarter compared to a provision of $2.1 million on pre-tax earnings of $6.1 million in the 2015 second quarter. The effective tax rates for each period were distorted by, among other things, gains and losses from financial instruments, foreign exchange, asset impairment, disposals, and other expense (income) that have been separately reported. The effective tax rate on earnings from continuing operations before separately reported items was 28.0% this quarter and 32.0% in the 2015 second quarter.

Discontinued Operations

Discontinued operations reported a loss, net of tax, of $4.9 million this quarter compared to $5.5 million in the 2015 second quarter. This quarter's net after-tax loss related to an impairment charge of $7.1 million in respect of VCPI, a net loss of $0.9 million from VCPI's operations, and an increase in indemnification provisions in respect of the U.S. Sale Transaction of $0.9 million, partially offset by a release of reserves for our U.S. self-insured liabilities of $4.0 million. The 2015 second quarter net after-tax loss of $5.5 million included a net loss of $0.1 million from VCPI's operations and the balance related to the operations disposed of in the U.S. Sale Transaction. For further information on the discontinued operations, refer to *note 17* of the unaudited interim condensed consolidated financial statements, and the discussions under the headings "Significant 2016 Events and Developments – Disposal Group Held for Sale – VCPI", and "Other Significant Developments – 2015 U.S. Sale Transaction".

2016 SIX MONTH FINANCIAL REVIEW

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

	Six months ended June 30						
			2016			2015	Total
(thousands of dollars)	Canada	U.S.	Total	Canada	U.S.	Total	Change
Revenue	**514,588**	**1,220**	**515,808**	426,789	344	427,133	88,675
Operating expenses	**454,466**	**–**	**454,466**	372,629	–	372,629	81,837
Net operating income	**60,122**	**1,220**	**61,342**	54,160	344	54,504	6,838
Administrative costs	**13,500**	**1,365**	**14,865**	10,629	3,488	14,117	748
Lease costs	**3,313**	**–**	**3,313**	2,646	–	2,646	667
Adjusted EBITDA	**43,309**	**(145)**	**43,164**	40,885	(3,144)	37,741	5,423
Depreciation and amortization	**14,900**	**–**	**14,900**	10,730	–	10,730	4,170
Other expense	**2,341**	**–**	**2,341**	2,489	–	2,489	(148)
Earnings (loss) before net finance costs and income taxes	**26,068**	**(145)**	**25,923**	27,666	(3,144)	24,522	1,401
Interest expense (net of capitalized interest)	**13,266**	**–**	**13,266**	16,390	–	16,390	(3,124)
Interest revenue	**(1,596)**	**(3,797)**	**(5,393)**	(1,585)	–	(1,585)	(3,808)
Accretion	**588**	**665**	**1,253**	554	654	1,208	45
Loss (gain) on foreign exchange	**2,011**	**2,745**	**4,756**	–	–	–	4,756
Net finance costs	**14,269**	**(387)**	**13,882**	15,359	654	16,013	(2,131)
Earnings (loss) from continuing operations before income taxes	**11,799**	**242**	**12,041**	12,307	(3,798)	8,509	3,532
Income tax expense (recovery)							
Current	**4,850**	**872**	**5,722**	5,920	(120)	5,800	(78)
Deferred	**(1,972)**	**79**	**(1,893)**	(2,526)	–	(2,526)	633
Total income tax expense (recovery)	**2,878**	**951**	**3,829**	3,394	(120)	3,274	555
Earnings (loss) from continuing operations	**8,921**	**(709)**	**8,212**	8,913	(3,678)	5,235	2,977
Earnings (loss) from discontinued operations	**–**	**(6,712)**	**(6,712)**	–	2	2	(6,714)
Net earnings (loss)	**8,921**	**(7,421)**	**1,500**	8,913	(3,676)	5,237	(3,737)
Earnings (loss) from continuing operations	**8,921**	**(709)**	**8,212**	8,913	(3,678)	5,235	2,977
Add (Deduct) (1):							
Loss (gain) on foreign exchange	**1,412**	**2,018**	**3,430**	–	–	–	3,430
Other expense	**1,721**	**–**	**1,721**	1,947	–	1,947	(226)
Earnings (loss) from continuing operations before separately reported items, net of taxes	**12,054**	**1,309**	**13,363**	10,860	(3,678)	7,182	6,181

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

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

	Six months ended June 30						
			2016			2015	Total
(thousands of dollars)	Canada	U.S.	Total	Canada	U.S.	Total	Change
Earnings (loss) from continuing operations before income taxes	**11,799**	**242**	**12,041**	12,307	(3,798)	8,509	3,532
Add (Deduct):							
Depreciation and amortization	**14,900**	**–**	**14,900**	10,730	–	10,730	4,170
Net finance costs	**14,269**	**(387)**	**13,882**	15,359	654	16,013	(2,131)
Other expense	**2,341**	**–**	**2,341**	2,489	–	2,489	(148)
Adjusted EBITDA	**43,309**	**(145)**	**43,164**	40,885	(3,144)	37,741	5,423
Add (Deduct):							
Administrative costs	**13,500**	**1,365**	**14,865**	10,629	3,488	14,117	748
Lease costs	**3,313**	**–**	**3,313**	2,646	–	2,646	667
Net operating income	**60,122**	**1,220**	**61,342**	54,160	344	54,504	6,838

The following provides our segmented “revenue”, “operating expenses” and “net operating income”.

Six months ended June 30 *(thousands of dollars)*	Long-term Care	Retirement Living	Home Health Care	Other Canadian Operations	Corporate Canada	Total Canada	Total U.S.	Total
2016 – Same-store								
Revenue	**298,720**	−	**100,966**	**9,255**	**8**	**408,949**	**1,220**	**410,169**
Operating expenses	**262,818**	−	**90,602**	**4,343**	−	**357,763**	−	**357,763**
Net operating income	**35,902**	−	**10,364**	**4,912**	**8**	**51,186**	**1,220**	**52,406**
Net operating income margin (%)	***12.0%***	−	***10.3%***	***53.1%***	***100.0%***	***12.5%***	***100.0%***	***12.8%***
2016 – Non Same-store								
Revenue	−	**7,038**	**98,601**	−	−	**105,639**	−	**105,639**
Operating expenses	−	**6,630**	**90,073**	−	−	**96,703**	−	**96,703**
Net operating income	−	**408**	**8,528**	−	−	**8,936**	−	**8,936**
Net operating income margin (%)	−	***5.8%***	***8.6%***	−	−	***8.5%***	−	***8.5%***
2016 – Total								
Revenue	**298,720**	**7,038**	**199,567**	**9,255**	**8**	**514,588**	**1,220**	**515,808**
Operating expenses	**262,818**	**6,630**	**180,675**	**4,343**	−	**454,466**	−	**454,466**
Net operating income	**35,902**	**408**	**18,892**	**4,912**	**8**	**60,122**	**1,220**	**61,342**
Net operating income margin (%)	***12.0%***	***5.8%***	***9.5%***	***53.1%***	***100.0%***	***11.7%***	***100.0%***	***11.9%***
2015 – Same-store								
Revenue	290,287	−	95,254	7,728	30	393,299	344	393,643
Operating expenses	255,350	−	83,503	3,644	−	342,497	−	342,497
Net operating income	34,937	−	11,751	4,084	30	50,802	344	51,146
Net operating income margin (%)	*12.0%*	−	*12.3%*	*52.8%*	*100.0%*	*12.9%*	*100.0%*	*13.0%*
2015 – Non Same-store								
Revenue	−	−	33,490	−	−	33,490	−	33,490
Operating expenses	−	−	30,132	−	−	30,132	−	30,132
Net operating income	−	−	3,358	−	−	3,358	−	3,358
Net operating income margin (%)	−	−	*10.0%*	−	−	*10.0%*	−	*10.0%*
2015 – Total								
Revenue	290,287	−	128,744	7,728	30	426,789	344	427,133
Operating expenses	255,350	−	113,635	3,644	−	372,629	−	372,629
Net operating income	34,937	−	15,109	4,084	30	54,160	344	54,504
Net operating income margin (%)	*12.0%*	−	*11.7%*	*52.8%*	*100.0%*	*12.7%*	*100.0%*	*12.8%*
Change in Total								
Revenue	8,433	7,038	70,823	1,527	(22)	87,799	876	88,675
Operating expenses	7,468	6,630	67,040	699	−	81,837	−	81,837
Net operating income	965	408	3,783	828	(22)	5,962	876	6,838

Consolidated Revenue

Consolidated continuing operations – revenue grew by $88.6 million, or 20.8%, to $515.8 million in the first six months of 2016, of which acquisitions contributed $72.1 million, with growth from same-store revenue of $16.5 million, or 4.2%.

Long-term care operations – revenue improved by $8.4 million, or 2.9%, to $298.7 million this period, primarily due to funding enhancements and an estimated $1.4 million due to the leap day this period. Approximately $2.4 million of the increase in revenue related to our Ontario flow-through envelopes and was therefore directly offset by increased costs of resident care, and approximately $0.5 million was due to improvements in preferred accommodation. Our average occupancy improved to 97.9% this period from 97.7% in the first six months of 2015, and our average daily revenue rate increased by 1.6% to $201.96 in the first six months of 2016 from $198.86 in the same 2015 period.

Retirement living operations – revenue from the Retirement Acquisitions completed since October 2015 was $7.0 million, with average occupancy of 56.3% and average monthly revenue per occupied room of $4,573 for the first six months of 2016. In accordance with the purchase agreements, the purchase price of four of the communities that had been open for less than a year when acquired, includes income support totalling $6.8 million to be released to Extendicare during the lease-up periods until the communities reach stabilized NOI. The realization of income support is not included in earnings reported in the consolidated statements of earnings, but it is included in the determination of AFFO. For the six months ended June 30, 2016, the Company realized $3.1 million of income support in determining AFFO. As at June 30, 2016, $3.6 million of the $6.8 million of income support had been realized.

Home health care operations – revenue improved by $70.8 million to $199.6 million, of which $65.1 million was from the Home Health Acquisition. Same-store revenue grew by $5.7 million primarily due to enhanced funding to support an increase in government-funded wage increases for personal support workers (PSWs), estimated at approximately $3.0 million, a 2.7% increase in daily hours of service provided to 14,349 in the first six months of 2016 from 13,969 in the same 2015 period, and the impact of the leap day. The average hourly service rate was $38.66 in the first six months of 2016 compared to $37.67 in the same 2015 period, and remained unchanged excluding the impact of the government funding for the PSW wage increases.

Other Canadian operations – revenue from our management and group purchasing operations improved by $1.5 million to $9.3 million in the first six months of 2016, primarily due to growth in the number of clients served.

U.S. operations – revenue from the Captive increased by $0.9 million to $1.2 million due to an increase in investment income.

Consolidated Operating Expenses

Consolidated continuing operations – operating expenses increased by $81.8 million, or 22.0%, to $454.5 million in the first six months of 2016, primarily as a result of acquisitions. The majority of our operating expenses are labour related, which increased by $75.4 million over the same 2015 period, and represented 86.9% and 85.8% of operating expenses in the first six months of 2016 and 2015, respectively, and as a percentage of revenue were 76.6% and 74.8%, respectively. Acquisitions contributed approximately $66.5 million to operating expenses this period, with same-store operating expenses increasing by 4.5%, primarily resulting from higher labour costs, which were impacted by the leap day this year.

Long-term care operations – operating expenses increased by $7.5 million to $262.8 million in the first six months of 2016, which included higher labour costs of approximately $5.5 million, or 2.6%. Labour costs of our long-term care operations represented 83.7% and 84.0% of operating expenses in the first six months of 2016 and 2015, respectively.

Retirement operations – operating expenses from the Retirement Acquisitions were $6.6 million, of which approximately $4.5 million, or 68.0%, were labour costs.

Home health care operations – operating expenses increased by $67.0 million to $180.7 million, of which $59.9 million was from the Home Health Acquisition. Same-store operating expenses grew by $7.1 million, of which approximately $3.0 million related to the government-funded wage increases, and the balance was largely due to labour costs to support the 2.7% increase in volumes. Labour costs of our home health care operations represented 92.6% and 89.9% of its operating expenses in the first six months of 2016 and 2015, respectively.

Other Canadian operations – operating expenses from our management and group purchasing operations increased by $0.7 million to $4.4 million in the first six months of 2016, primarily related to the growth in clients served.

Consolidated Net Operating Income

Consolidated net operating income from continuing operations improved by $6.8 million, or 12.5%, to $61.3 million in the first six months of 2016 compared to $54.5 million in the same 2015 period, representing 11.9% and 12.8% of revenue, respectively. As discussed above, revenue increased by $88.6 million and was partially offset by higher operating expenses of $81.8 million, which included a $75.4 million increase in labour costs. On a same-store basis, excluding the Home Health Acquisition and Retirement Acquisitions, net operating income improved by $1.2 million to $52.4 million, representing 12.8% of revenue in the first six months of 2016 compared to 13.0% in the same 2015 period. This improvement in same-store net operating income resulted from funding enhancements in our long-term care operations, higher preferred accommodation revenue, increased business volumes in our management services and group purchasing operations and higher investment income from our Captive, partially offset by unfunded cost increases in our home health care operations, as previously discussed under the review of the second quarter results. Management initiatives are under way with a specific focus to improve efficiency and reduce costs in our core home health care operations over time.

Administrative and Lease Costs

Administrative and lease costs increased by $1.4 million to $18.2 million in the first six months of 2016. The administrative and lease costs of our Canadian operations increased by $3.5 million, of which approximately $0.6 million represented additional lease costs associated with the Home Health Acquisition, $1.2 million was due to an increase in labour costs primarily in connection with acquisitions, and the balance was largely due to an increase in professional fees in support of services related to the sold operations, recent acquisitions, an executive compensation review and the implementation of a new long-term incentive plan. The administrative and lease costs from our U.S. operations declined by $2.1 million, primarily due to a reduction in costs to manage the run off of our U.S. self-insured liabilities.

Consolidated Adjusted EBITDA

Consolidated Adjusted EBITDA improved to $43.1 million in the first six months of 2016 from $37.7 million in the same 2015 period, representing 8.4% and 8.8% of revenue, respectively. The increase of $5.4 million in Adjusted EBITDA, reflected growth in net operating income of $6.8 million, partially offset by the increase in administrative and lease costs, previously discussed.

Depreciation and Amortization

Depreciation and amortization costs increased by $4.2 million to $14.9 million in the first six months of 2016, largely due to the acquisitions.

Other Expense

Extendicare recorded a pre-tax loss of $2.3 million in the first six months of 2016, of which $1.9 million related to proxy contest costs and the balance to integration and acquisition costs. In comparison, a pre-tax loss of $2.5 million was incurred in the same 2015 period related to acquisition costs.

Net Finance Costs (Income)

Net finance costs decreased by $2.1 million to $13.9 million in the first six months of 2016, and included lower interest expense of $3.1 million and higher interest revenue of $3.8 million, partially offset by a foreign exchange loss of $4.8 million. Interest expense in 2015 included $2.2 million related to the bridge loan used to acquire the Home Care Acquisition and in the first six months of 2016, $0.5 million of interest expense was capitalized in connection with construction projects. Interest revenue included $3.8 million (US$2.8 million) in connection with deferred consideration. The foreign exchange loss included $2.0 million in respect of net cash proceeds from the U.S. Sale Transaction, most of which was unrealized, and $2.7 million unrealized foreign exchange loss in connection with deferred consideration from the U.S. Sale Transaction.

Income Taxes

The income tax provision was $3.8 million on a pre-tax loss of $12.0 million in the first six months of 2016 compared to a provision of $3.3 million on pre-tax earnings of $8.5 million in the same 2015 period. The effective tax rates for each period were distorted by, among other things, gains and losses from financial instruments, foreign exchange, asset impairment, disposals, and other expense (income) that have been separately reported. The effective tax rate on earnings from continuing operations before separately reported items was 30.2% in the first six months of 2016 and 34.7% in the same 2015 period.

Discontinued Operations

Discontinued operations reported a loss, net of tax, of $6.7 million in the first six months of 2016 compared to nil in the same 2015 period. This period's net after-tax loss related to an impairment charge of $7.1 million in respect of VCPI, a net loss of $1.9 million from VCPI's operations, and an increase in indemnification provisions in respect of the U.S. Sale Transaction of $1.7 million, partially offset by a release of reserves for our U.S. self-insured liabilities of $4.0 million. The net earnings from discontinued operations of nil reported in the first six months of 2015 included a net loss of $0.3 million from VCPI's operations offset by net earnings from the operations disposed of in the U.S. Sale Transaction. For further information on the discontinued operations, refer to *note 17* of the unaudited interim condensed consolidated financial statements, and the discussions under the headings "Significant 2016 Events and Developments – Disposal Group Held for Sale – VCPI", and "Other Significant Developments – 2015 U.S. Sale Transaction".

OTHER SIGNIFICANT DEVELOPMENTS

The discussion under the heading "Significant 2016 Events and Developments" summarizes our current activities to expand into the retirement sector. This section provides a summary of other developments that have impacted the financial results or operations of Extendicare for 2016 in comparison to 2015.

2015 U.S. Sale Transaction

As previously announced, effective July 1, 2015, the Company completed the sale of substantially all of its U.S. business and senior care operations by selling all of the issued and outstanding shares of a subsidiary to a group of private investors (the "Purchaser"). At the time of the sale, EHSI's senior care portfolio comprised 156 owned/leased centres (15,183 beds) located in 12 states. The U.S. Sale Transaction was completed for a value of US$870 million ($1.1 billion using the noon U.S./Canadian dollar exchange rate of 1.2474 on June 30, 2015), partially settled through the assumption by the Purchaser of mortgage loans and other third-party indebtedness relating to the U.S. business of approximately US$655 million, and working capital and other specified adjustments, resulting in gross proceeds of US$280.8 million representing US$193.4 million received on July 1, 2015, and an intercompany dividend of US$87.4 million received as part of a pre-closing reorganization on June 30, 2015 (the "Pre-closing Distribution"). The Company has agreed to indemnify the Purchaser for certain obligations of the U.S. operations related to tax, a corporate integrity agreement, and other items, and had recorded provisions totalling US$25.2 million and a potential receivable of approximately US$9.3 million, for a potential net liability of US$15.9 million. In connection with these items, as at June 30, 2016, the Company had provisions remaining totalling US$20.3 million and a receivable of US$5.2 million. Total estimated taxes of the U.S. Sale Transaction were US$33.1 million, resulting in net after-tax proceeds of approximately US$231.8 million, including the Pre-closing Distribution. The U.S. Sale Transaction resulted in an after-tax gain of $205.4 million (US$146.9 million), before transactions costs, and included the realization of a foreign currency translation adjustment of $22.0 million, previously recognized in accumulated other comprehensive income.

The U.S. Sale Transaction included non-cash proceeds of US$6.2 million, which represented the net present value ascribed to an ongoing cash stream of US$28.0 million, recorded as deferred consideration, relating to certain U.S. skilled nursing centres that were leased prior to the closing, offset in part by obligations of US$21.8 million that were assumed related to these leases. On July 1, 2015, US$6.8 million of the obligation was settled, and in the first six months of 2016 a further US$9.0 million was settled, leaving a balance owing of US$6.0 million as at June 30, 2016. Cash of US$14.0 million had been placed in escrow on July 1, 2015, to secure the obligations, of which US$6.0 million remains in other assets on the consolidated statements of financial position. The estimated benefit of this cash stream, net of the obligations, is anticipated to average US$5 million per annum (pre-tax) over 15 years. There are significant credit risks associated with the realization of this cash stream attributable to factors outside of Extendicare's control that could materially negatively impact the amounts that are expected to be received by the Company (refer to *notes 7 and 10* of the unaudited interim condensed consolidated financial statements).

In October 2014, EHSI completed and executed a settlement agreement with the U.S. Department of Justice (DOJ), the Office of the Inspector General (OIG) of the U.S. Department of Health and Human Services and multiple states, which fully and finally resolved the DOJ and OIG investigations and ancillary claims that were pending since 2010. As is standard practice in settlements of OIG and DOJ investigations, EHSI entered into a corporate integrity agreement, or CIA, with the OIG for a five-year period effective October 3, 2014. Under the terms of the U.S. Sale Transaction, Extendicare has agreed to share in the costs incurred in order to implement and comply with the requirements of the CIA. Extendicare's annual cost sharing arrangement with the Purchaser is capped at US$4.5 million, on the basis that the first US$2.0 million aggregate annual amount of such costs will be borne by the Purchaser; the next US$2.0 million aggregate annual amount will be borne by Extendicare; with the next US$5.0 million aggregate annual amount to be shared equally between the Purchaser and Extendicare; and the balance of any excess costs incurred to be borne by the Purchaser. Extendicare estimates that its obligations to the Purchaser relating to the CIA will average approximately US$2.0 million per year to October 2019. Though the actual costs for the Purchaser to comply with the CIA are difficult to estimate, the Company has included a provision for such costs in its provision for indemnification obligations, as discussed above. For further information refer to *note 7* of the unaudited interim condensed consolidated financial statements.

Not included in the U.S. Sale Transaction were 10 U.S. skilled nursing centres disposed of separately, either prior to or on June 30, 2015, for proceeds, net of debt assumed, of $21.1 million, or approximately US$11.1 million after tax, that resulted in a pre-tax gain of approximately $3.8 million (US$3.1 million). All of the net after-tax cash proceeds related to these 10 centres were distributed to the Company by its U.S. subsidiary in the form of intercompany cash dividends prior to the closing of the U.S. Sale Transaction. In addition, net working capital of approximately $5.5 million (US$4.4 million) from these centres was retained by the Company, and included as part of the Pre-closing Distribution, discussed above.

On June 30, 2015, EHSI obtained a US$60.0 million non-recourse term loan from General Electric Capital Corporation. The proceeds of this loan, together with available cash, were used by EHSI to make a cash dividend payment totalling $103.5 million (US$83.0 million) on June 30, 2015, to its Canadian parent company as part of the Pre-closing Distribution discussed above. This debt was assumed by the Purchaser in connection with the U.S. Sale Transaction.

Further information relating to the U.S. Sale Transaction is available in the Company's related material change report dated November 17, 2014, filed on SEDAR at www.sedar.com under Extendicare's issuer profile.

2015 Home Health Acquisition

As previously announced, on April 30, 2015, the Company completed the Home Health Acquisition for $84.3 million in cash, which included final working capital adjustments and settlement of amounts that had been held in escrow.

The Home Health Acquisition was financed with a bridge loan of $80 million (the "Bridge Loan") and cash on hand. The Bridge Loan was repaid in full on July 2, 2015, from a portion of the proceeds from the U.S. Sale Transaction, and bore interest at an average rate of 5.93% per annum, incurring interest charges of approximately $0.8 million. In addition, financing fees of $1.4 million were incurred in connection with securing the Bridge Loan and were fully amortized in the 2015 second quarter.

For the 2016 second quarter, the Home Health Acquisition contributed revenue of approximately $50.5 million, net operating income of approximately $5.1 million, and AFFO of approximately $3.3 million, or $0.037 per basic share. For the six months ended June 30, 2016, the Home Health Acquisition contributed revenue of approximately $98.6 million, net operating income of approximately $8.5 million, and AFFO of approximately $5.6 million, or $0.064 per basic share. For the eight months of ownership ending December 31, 2015, the Home Health Acquisition contributed revenue of approximately $131.6 million, net operating income of approximately $13.2 million, lease costs of approximately $1.4 million, and AFFO of approximately $8.4 million, or $0.096 per basic share.

The Home Health Acquisition brought together two leading Canadian private-sector home health care providers focused on quality, person-centred care and employee satisfaction. Extendicare has rebranded these acquired operations under its ParaMed banner across six provinces (Ontario, British Columbia, Alberta, Manitoba, Quebec and Nova Scotia). Further information relating to the Home Health Acquisition is available in the Company's related material change report dated January 23, 2015, filed on SEDAR at www.sedar.com under Extendicare's issuer profile.

RBC Credit Facility

Extendicare has a demand credit facility with the Royal Bank of Canada (the "RBC Credit Facility") that is secured by 13 class "C" LTC centres in Ontario and is guaranteed by certain Canadian subsidiaries of Extendicare. Subsequent to June 30, 2016, the RBC Credit Facility was amended to increase the amount available to $47.3 million from $46.8 million, and to make the full amount available for operating purposes and for letters of credit. .

As at June 30, 2016, Extendicare had letters of credit totalling approximately $41.9 million issued under the RBC Credit Facility, of which $40.4 million secure our defined benefit pension plan obligations and the balance was in connection with the recently acquired centres and those under development. The letter of credit to secure the pension plan obligations renews annually based on an actuarial valuation, and decreased in May 2016 from $42.8 million to $40.4 million. The RBC Credit Facility has no financial covenants, but does contain normal and customary terms including annual re-appraisals of the centres that could limit the maximum amount available.

Tax Rules and Regulations

In 2015, the Company received a notice of assessment from the Canada Revenue Agency (CRA) for the 2012 taxation year with regards to the deductibility of interest on intercompany debt between wholly owned subsidiaries of Extendicare. The CRA is likely to issue reassessments for the 2013 and 2014 taxation years on the same or similar basis, and as a result, in the 2015 third quarter, Extendicare recorded a provision of $3.6 million for the full amount of the taxes in dispute for those periods, reflected as part of current tax expense. The Company has filed a notice of objection to appeal, and if successful in defending its position, in whole or in part, some or all of the provision will be reversed. Given the nature of this item, including the fact that it relates to prior periods, it has been excluded from the determination of AFFO and "earnings (loss) from continuing operations before separately reported items".

Legal Proceedings and Regulatory Actions

The provision of health care services is subject to complex government regulations. Extendicare and its consolidated subsidiaries are defendants in various actions and proceedings that are brought against them from time to time in connection with their operations. Extendicare cooperates in responding to any information requests and takes the necessary corrective actions. Every effort is made by the Company to avoid or mitigate deficiencies in the quality of patient care through quality assurance strategies and to remedy any such deficiencies cited by government inspections within any applicable prescribed time period. Extendicare accrues for costs that may result from investigations (or any possible related litigation) to the extent that an outflow of funds is probable and a reliable estimate of the amount of the associated costs can be made.

UPDATE OF REGULATORY AND FUNDING CHANGES AFFECTING RESULTS

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

In most provinces, a license must be obtained from the applicable provincial ministry of health in order to operate either a long-term care centre or a retirement centre. In general, there has not been any issuance of new LTC licenses across the country because of the funding implications for governments. In addition to the license procedure, or in some provinces in place of, operators in Alberta, Manitoba, Ontario and Saskatchewan are required to sign service contracts that incorporate service expectations with the provincial government or regional health authority. In Ontario, the *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 of up to 30 years, after which a new license may or may not be issued; the revocation of a license for continued 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 notification of whether or not a new license will be issued at least three years before the end of the license term.

Ontario Redevelopment Program

On February 27, 2015, the Ministry of Health and Long-Term Care (the "MOHLTC") released updates to its plan to redevelop approximately 31,000 older long-term care beds by the end of 2025. The new per diem construction funding subsidy includes: an increase to the base rate from $13.30 to $16.65 per bed for large centres of 161 beds or more; an incremental per diem of $1.50 per bed for small centres with up to 96 beds; an incremental per diem of $0.75 per bed for medium centres with 97 to 160 beds; and a per diem of up to $0.38 per bed for those centres eligible for enhanced transition support. In addition, LTC centres are no longer required to meet Leadership in Energy and Environmental Design, or LEED, construction standards; however, those that achieve LEED Silver status will continue to receive a per diem premium of $1.00 per bed. Following their redevelopment, LTC centres meeting the enhanced design standards will be eligible to receive a 30-year license. In addition, the government amended the LTC Act 2007 to extend the maximum term of LTC centre licenses for "New" and "A" beds by five years (to a maximum of 30 years), effective January 1, 2015.

Extendicare owns 21 LTC centres with 3,287 class "C" beds in Ontario and expects to redevelop centres under this enhanced program. Approval from the MOHLTC has been requested to move ahead with our first project, and we are continuing to analyze the opportunities with the remainder of our portfolio under the program.

In 2013, Extendicare participated in phase one of the program and redeveloped two class "C" centres (436 beds) that qualified for a construction funding subsidy of $14.30 per bed per day over 25 years. In the 2015 third quarter, the MOHLTC confirmed that these two LTC centres were eligible to retroactively receive an additional $3.35 per bed per day of construction funding subsidy and, the Company recorded the present value of this anticipated additional funding in the amount of $9.8 million as an increase in government notes receivable, with an offset to the cost of the buildings. In the 2016 first quarter, the related MOHLTC agreements were finalized and funding of the additional subsidy commenced. Based on the finalized agreements, the number of redeveloped beds deemed eligible to receive the additional funding changed, resulting in a reassessment of the estimate of the present value of the additional funding to $6.4 million. In addition, the Company has 11 "New" centres that were built since 1998, and therefore in aggregate Extendicare receives annual construction funding subsidies of $7.7 million. Refer to *note 6* of the unaudited interim condensed consolidated financial statements, for additional information.

Ontario Long-term Care Funding

Ontario is Extendicare's largest market for its senior care services. Funding for Ontario long-term care centres is based on reimbursement for the level of care assessed to be required by the residents, in accordance with scheduled rates. The MOHLTC allocates funds through "funding envelopes", specifically: nursing and personal care (NPC); programs and support services (PSS); and accommodation (which includes a sub-envelope for raw food). The funding for the NPC and PSS envelopes is generally adjusted annually based on the acuity of residents as determined by a classification assessment of resident care needs. The NPC, PSS and food envelopes are "flow-through" envelopes, whereby any deviation in actual costs from scheduled rates is either absorbed by the provider (if actual costs exceed funding allocations) or is returned to the MOHLTC (if actual costs are below funding allocations). With respect to the accommodation envelope, providers retain any excess funding received over costs incurred. The province sets the rates for standard accommodation, as well as the maximum amounts that a provider can charge for semi-private and private accommodation (preferred accommodation). The provider is allowed to bill and retain the premiums charged for preferred accommodation. The accommodation rates are substantially paid for by the resident; however, the province guarantees funding for standard accommodation through resident subsidies. Overall government funding is occupancy-based, but once the average occupancy level of 97% or higher is achieved, operators receive government funding based on 100% occupancy. In 2011, the MOHLTC implemented an occupancy protection program for occupancy levels between 90% and less than 97%, provided certain policy conditions are met. Under the occupancy protection program, providers with occupancy levels equal to 90% and less than 94% receive funding based on their actual occupancy plus 1%, and those with occupancy levels equal to 94% and less than 97% receive funding based on their actual occupancy plus 2%. For 2015, all of Extendicare's LTC centres in Ontario achieved the 97% occupancy threshold, with an overall average of 98.2%.

On April 1st each year, the MOHLTC generally provides flow-through funding adjustments on the government funded portion of the fees. Funding for the NPC and PSS flow-through envelopes increased by 2% on April 1, 2016. These enhancements, along with our CMI and re-indexing adjustments, are estimated to provide Extendicare with additional revenue of approximately $1.8 million to offset additional costs for resident care and services within the NPC and PSS flow-through envelopes (April 2015 – $1.3 million).

On July 1st each year, the MOHLTC generally implements annual accommodation funding increases to the per diem rates provided to long-term care providers. The July 1, 2016 funding enhancements increased the daily rates for the non flow-through component of the accommodation envelope by $0.59 (1.1%) and by $0.30 (3.74%) for the flow-through food component. Extendicare estimates that this enhanced funding represents additional annual revenue of approximately $1.7 million in total, of which approximately $0.6 million is flow-through funding (July 2015 – $1.8 million in total of which $0.3 million was flow-through).

In addition, LTC operators in Ontario are permitted to designate up to 60% of the resident capacity of a centre as preferred accommodation at higher fixed rates that vary according to the structural classification of the LTC centre. For beds that are not classified as "New" or "A" beds, the maximum preferred accommodation premiums increased effective July 1, 2016, by $0.09 to $8.09 per day for a semi-private room and by $0.20 to $18.20 per day for a private room. For beds that are classified as "New" and "A" beds, the maximum preferred accommodation premiums increased effective July 1, 2016, by $0.13 to $12.13 per day for a semi-private room and by $0.28 to $25.28 per day for a private room. As at June 30, 2016, Extendicare had 13 "New" LTC centres (1,847 beds) in Ontario, of which 1,099 beds offered preferred accommodation in the form of private rooms. We will benefit from this premium increase for preferred accommodation over time as new residents are admitted.

Alberta Long-term Care Legislation and Funding

Alberta is Extendicare's second largest market for its senior care services. Since April 2010, AHS has been using an activity-based funding system for continuing care centres that includes the measurement of a resident's acuity through the use of a resident assessment instrument – minimum data set, or RAI-MDS, to determine the resident's level of care and resources required. The Alberta Continuing Care Association is actively engaged in discussions with the Alberta Government and AHS to further increase care funding to accommodate expenses within continuing care, and to revise the existing funding model used within continuing care. It was anticipated that a revised care funding model would be implemented for fiscal 2016/2017; however, the provincial government has not communicated any changes to date, and are seeking public input into the current nursing home regulations to inform new or revised legislation expected in the fall.

With respect to the annual April 1st, government funding changes for long-term care providers for fiscal 2016/2017, incorporating changes to CMI, occupancy and an inflationary component, are estimated to represent additional annual revenue for Extendicare of approximately $1.2 million (2015 – $1.4 million).

On July 1, 2016, the long-term care and designated supportive living accommodation fees (the portion paid directly by the residents) increased by 3%, as was the case in 2015 and 2014, to recognize the rising costs of delivering accommodation and related services. Extendicare estimates that the 3% increase received in July 2016 represents additional annual revenue of approximately $0.9 million. Beginning on July 1, 2017, annual accommodation charge adjustments will be based solely on inflation as reflected by Alberta's CPI.

Ontario Home Health Care Legislation and Funding

Extendicare's ParaMed Home Health Care division operates in six provinces across Canada, currently providing approximately 10.6 million hours of care annually, which we believe makes ParaMed the largest private-sector provider of publicly funded home health care in Canada, and the largest in Ontario. Based on the service volumes provided in the 2016 first quarter, the Ontario market represents approximately 85% of ParaMed's service volumes, of which approximately 97% was received from government-funded contracts at specified rates, and the remainder from private-pay clients.

At present, the government rates are pre-determined between the CCAC and the service provider, with different rates for different services provided. The current service rates have remained static since they were last contracted under the competitive bidding model. Based upon a recommendation from the Auditor General's special report on the CCACs in September 2015, the MOHLTC is initiating work with the CCACs and home-care service providers to move toward harmonized billing rates. The MOHLTC has stated that they will work on this initiative over the next two years. Management is unable to predict whether the MOHLTC will adopt changes to the home health care billing rates, and if adopted and implemented, what effect such changes will have on the Company's home health care operations.

In December 2015, the Ontario government released a discussion paper called *Patient's First: A Proposal to Strengthen Patient-Centered Health Care in Ontario*. In the discussion paper, the MOHLTC envisions that the provinces 14 Local Health Integration Networks (LHINs) will have a greatly expanded role, making them responsible and accountable for all health service planning and performance across the Ontario health care continuum. On June 2, 2016, Bill 210, now known as the "Patients First Act", was introduced into the legislature. If passed, the proposed Act sets the stage for the legislative change process required to achieve the vision introduced in 2015. Bill 210 amends the Local Health System Integration Act, 2006, and makes related amendments to more than twenty other pieces of legislation. Major elements of Bill 210 include the removal of the CCACs from the definition of "health services providers", and introduces rules governing the transfer of the CCACs' assets and staff to the LHINs, in addition to increasing the size and span of control of the LHIN boards. Extendicare is monitoring the impact of this change and working with sector associations to mitigate operational risk.

On July 19, 2016, the MOHLTC announced $100 million of funding to enhance support for home care clients with high needs and their caregivers, with $80 million earmarked for enhanced home care and $20 million for caregiver respite. The funding is expected to support 350,000 additional hours of nursing care, 1.3 million additional hours of personal support, 600,000 additional hours of respite services for caregivers and 100,000 additional hours of rehabilitation. This additional funding is part of the government's 2015 budget commitment to increase investments in home and community care by more than $750 million over three years. We are pleased that the government continues to invest in home care but at this time, management is uncertain as to how the hours will be distributed among the 14 different CCACs, or when the additional hours are expected to be implemented.

2014 ONTARIO BUDGET – HOME HEALTH CARE PSW WAGE INCREASE

As part of its July 2014 budget, the Ontario government announced a government-funded increase in the minimum wage for personal support workers, or PSWs, in the publicly funded home and community care sector by $4.00 per hour over three years (2014 – $1.50, 2015 – $1.50 and 2016 – $1.00) to a minimum of $16.50 per hour. In June 2015, the government announced revisions to years two and three of the PSW wage enhancement initiative, which included establishing a new minimum base rate of $15.50 per hour as of April 1, 2015, and $16.50 per hour as of April 1, 2016, and limiting the eligibility for the April 1, 2015, wage increase to a maximum of $19.00 per hour. For example, a qualifying PSW earning $18.00 per hour would receive a $1.00 per hour increase effective April 1, 2015, rather than the full $1.50. In addition, the government is funding an additional 22.7% of the wage increase to cover incremental benefit costs. We estimate that the April 1, 2014, funding increase of $1.50 in base wages and associated benefit costs increased our revenue and labour costs by approximately $5.7 million for the nine months ended December 31, 2014, and by approximately $7.5 million for the twelve months ended March 31, 2015. We estimate that the April 1, 2015, funded wage enhancement has further increased our revenue and labour costs by approximately $12.1 million for the twelve months ended March 31, 2016, of which approximately $4.4 million related to the operations of the Home Health Acquisition. The final funding increase of up to $1.00 in base wages and associated benefit cost took effect on April 1, 2016, and is estimated to increase our annual revenue and labour costs by approximately $7.0 million.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes the sources and uses of cash between our continuing and discontinued operations for each of the six months ended June 30, 2016 and 2015.

	Six months ended June 30, 2016			Six months ended June 30, 2015		
(thousands of dollars unless otherwise noted)	**Continuing**	**Discontinued**	**Total**	**Continuing**	**Discontinued**	**Total**
Cash provided by operating activities, before working capital changes and interest and income taxes	**43,560**	**(614)**	**42,946**	37,727	66,293	104,020
Net change in operating assets and liabilities						
Accounts receivable	**(2,061)**	**1,086**	**(975)**	(6,906)	26,242	19,336
Other assets	**9,864**	**(85)**	**9,779**	(7,065)	1,912	(5,153)
Accounts payable and accrued liabilities	**(24,636)**	**236**	**(24,400)**	16,323	(21,015)	(4,692)
	(16,833)	**1,237**	**(15,596)**	2,352	7,139	9,491
Interest and taxes paid						
Interest paid	**(13,035)**	**(8)**	**(13,043)**	(14,159)	(17,721)	(31,880)
Interest received	**5,394**	**–**	**5,394**	1,566	128	1,694
Income taxes paid	**(13,223)**	**–**	**(13,223)**	(5,668)	(7,935)	(13,603)
Payments for U.S. self-insured liabilities	**–**	**(19,549)**	**(19,549)**	–	(21,705)	(21,705)
	(20,864)	**(19,557)**	**(40,421)**	(18,261)	(47,233)	(65,494)
Net cash from operating activities	**5,863**	**(18,934)**	**(13,071)**	21,818	26,199	48,017
Net cash from investing activities	**(46,424)**	**18,511**	**(27,913)**	(85,485)	10,051	(75,434)
Net cash from financing activities	**(23,705)**	**(115)**	**(23,820)**	36,447	60,850	97,297
Net cash from discontinued operations	**(538)**	**538**	**–**	134,836	(134,836)	–
Foreign exchange gain (loss) on U.S. cash held	**(210)**	**–**	**(210)**	98	4,435	4,533
Increase (decrease) in cash and short-term investments	**(65,014)**	**–**	**(65,014)**	107,714	(33,301)	74,413
Cash and short-term investments at beginning of year	**103,622**	**–**	**103,622**	35,495	63,304	98,799
Cash and short-term investments at end of period	**38,608**	**–**	**38,608**	143,209	30,003	173,212
Average U.S./Canadian dollar exchange rate			**1.3302**			1.2354

As at June 30, 2016, Extendicare had cash and short-term investments of $38.6 million compared with $103.6 million at the beginning of the year. The decline in cash of $65.0 million included the unleveraged acquisition completed in February 2016 for $40.5 million, $8.2 million related to income taxes paid of $22.1 million in excess of current income tax expense of $13.9 million, related to timing of payment of prior year's taxes, principal debt repayments of $10.5 million, and growth capital expenditures of $7.9 million, partially offset by construction financing issued of $2.3 million.

Discontinued operations for the 2016 period reflects the $19.5 million (US$14.7 million) of claim payments made during the quarter that were funded by the Captive's investments held for self-insured liabilities, which are not included in cash and short-term investments, and the discontinued operations of VCPI.

Net cash from operating activities of the continuing operations was $5.9 million in the first six months of 2016 compared to $21.8 million in the same 2015 period. The decline in cash from continuing operating activities of $15.9 million was primarily due to improvements in earnings offset by an unfavourable net change in operating assets and liabilities of $19.2 million and a net increase in interest and taxes paid of $2.6 million, largely due to the timing of payments. Approximately $11.1 million of the accounts payable and accrued liabilities payments made this period was funded by cash held in escrow that was recognized as a source of cash from investing activities, as described below.

Net cash from investing activities of the continuing operations was a use of cash of $46.4 million in the first six months of 2016 compared to a use of cash of $85.5 million in the same 2015 period. The 2016 activity included the $40.5 million acquisition of two retirement communities in February 2016, taxes paid of $8.9 million in connection with the U.S. Sale Transaction, and purchases of property, equipment and other intangible assets of $11.1 million, partially offset by a release of funds held in escrow of $11.1 million (US$8.0 million) to support obligations assumed in respect of the former U.S. operations and the collection of other assets of $3.0 million. The 2015 activity primarily related to the Home Health Acquisition of $83.6 million.

The following table summarizes the components of our property, equipment and other intangible asset expenditures between our continuing and discontinued operations for each of the six months ended June 30, 2016 and 2015. The increase in growth capex relates primarily to the retirement communities currently under development in Ontario. We are projecting to spend in the range of $13 million to $16 million in maintenance capex in 2016, and in the range of $35 million to $40 million in growth capex related primarily to the retirement development projects.

		Six months ended June 30, 2016			Six months ended June 30, 2015	
(thousands of dollars)	**Continuing**	**Discontinued**	**Total**	**Continuing**	**Discontinued**	**Total**
Growth capex						
Canadian operations	**7,766**		7,766	867	−	867
U.S. operations	**−**	**696**	696	−	23	23
Deduct: capitalized interest	**(524)**		(524)	−	−	−
Growth capex	**7,242**	**696**	7,938	867	23	890
Maintenance capex						
Canadian operations	**3,875**		3,875	3,110	−	3,110
U.S. operations	**−**	**342**	342	−	7,889	7,889
Maintenance capex	**3,875**	**342**	4,217	3,110	7,889	10,999
	11,117	**1,038**	12,155	3,977	7,912	11,889

Net cash from financing activities of the continuing operations was a use of cash of $23.7 million in the first six months of 2016 compared to a source of cash of $36.5 million in the same 2015 period. The 2016 activity included scheduled debt repayments of $10.5 million and cash dividends paid of $17.6 million, partially offset by a $2.3 million draw on our construction financing. The 2015 activity included the issuance of the $80.0 million Bridge Loan to finance the Home Health Acquisition, partially offset by scheduled debt repayments of $13.4 million, cash dividends paid of $17.9 million, and Common Shares acquired for cancellation under a normal course issuer bid at a cost of $7.5 million. For information on the change in long-term debt, refer to "Liquidity and Capital Resources – Long-term Debt".

Net cash from discontinued operations reflects the intercompany movements of cash between the discontinued and continuing operations. The 2016 activity of $0.5 million relates to the net change in cash of VCPI. The $134.8 million of cash received in the first six months of 2015, related primarily to the Pre-closing Distribution of US$83.0 million received as part of the U.S. Sale Transaction and other cross-border dividends of US$20.4 million.

Capital Structure

The following table summarizes our shareholders' equity for the six months ended June 30, 2016, and the 2015 year.

(thousands of dollars unless otherwise noted)	**Six months ended June 30, 2016**	**Year 2015**
Shareholders' Equity		
Common Shares	**486,936**	483,385
Equity portion of convertible debentures	**5,573**	5,573
Contributed surplus	**396**	−
	492,905	488,958
Accumulated deficit at beginning of year	**(315,051)**	(503,143)
Net earnings for the period	**1,500**	232,078
Dividends declared	**(21,166)**	(42,125)
Purchase of Common Shares in excess of book value and other	**(4)**	(1,861)
Accumulated deficit at end of period	**(334,721)**	(315,051)
Accumulated other comprehensive income (loss)	**2,571**	(1,778)
Shareholders' equity	**160,755**	172,129
U.S./Canadian dollar exchange rate at end of period	**1.2917**	1.3840

Share Information *(thousands)*	**July 31, 2016**	**June 30, 2016**	December 31, 2015
Common Shares (TSX symbol: EXE) (1)	**88,433.0**	**88,367.3**	87,953.3

(1) Closing market value per the TSX on July 31, 2016, was $8.21.

The closing rates used to translate assets and liabilities of the U.S. operations were 1.2917 at June 30, 2016, and 1.3840 at December 31, 2015. As a result of the stronger Canadian dollar as at June 30, 2016, compared to December 31, 2015, the foreign currency translation adjustment account declined by $1.8 million, due to the devaluation in net assets of our continuing self-sustaining U.S. operations, representing an increase (decrease) in net assets of approximately $0.2 million for every one-cent weakening (strengthening) of the Canadian dollar against the U.S. dollar.

DISTRIBUTIONS

In the first six months of 2016, we generated AFFO of $31.4 million and declared monthly dividends of $0.04 per share, totalling $21.2 million, which were paid out from February 16, 2016 to July 15, 2016. The portion distributed in cash was $17.7 million, and $3.5 million was by way of shares issued under a dividend reinvestment plan. A total of 413,999 Common Shares were issued in 2016 through the dividend reinvestment plan.

In the 2015 year, we generated AFFO of $50.8 million and declared monthly dividends of $0.04 per share, totalling $42.1 million, which were paid out from February 17, 2015 to January 15, 2016. The portion distributed in cash was $35.6 million, and $6.5 million was by way of shares issued under a dividend reinvestment plan. A total of 870,004 Common Shares were issued in 2015 through the dividend 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 “2016 Selected Quarterly Information”, “Adjusted Funds from Operations”, “2016 Second Quarter Financial Review”, and “Six Month Financial Review”.

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

NORMAL COURSE ISSUER BID

On December 30, 2015, Extendicare received the approval of the TSX to renew its normal course issuer bid (the “Bid”) to purchase for cancellation up to 8,610,000 Common Shares (approximately 10% of the public float) through the facilities of the TSX, and on alternative Canadian trading systems. The Bid commenced on January 5, 2016, and provides Extendicare with flexibility to repurchase Common Shares for cancellation until January 4, 2017, or on such earlier date as the Bid is complete. Subject to the TSX’s block purchase exception, on any trading day, purchases under the Bid will not exceed 59,253 Common Shares. The price that Extendicare will pay for any Common Shares purchased under the Bid will be the prevailing market price at the time of purchase and any Common Shares purchased will be cancelled. To date in 2016, the Company has not acquired any Common Shares for cancellation under the Bid.

During 2015, under a similar normal course issuer bid that commenced on December 31, 2014, and expired on December 30, 2015, the Company acquired 1,111,789 Common Shares for cancellation, at an average price of $7.20 per share, for a total cost of $8.0 million.

ACCRUAL FOR U.S. SELF-INSURED LIABILITIES

As a result of the sale of our U.S. senior care operations, our expense for self-insured liabilities was reclassified to discontinued operations. However, the obligation to settle any claims incurred prior to the closing of the U.S. Sale Transaction, including claims incurred but yet to be reported, remains with Extendicare within the Captive. Consequently, the balance of the accrual for self-insured liabilities and the related investments held for self-insured liabilities remain on the consolidated statement of financial position as part of the Company’s continuing operations.

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.

As at June 30, 2016, the accrual for self-insured general and professional liabilities was $116.1 million (US$89.9 million) compared to $148.4 million (US$107.2 million) at the beginning of the year. The decline of US$17.3 million reflected claim payments of US$14.7 million and a release of reserves of US$3.1 million, partially offset by US$0.5 million in accretion of the discounted liability. The $4.0 million (US$3.1 million) release of reserves in the 2016 second quarter followed the completion of an interim independent actuarial review that confirmed the adequacy of our reserves.

For the 2015 year, payments for self-insured liabilities were $42.1 million (US$32.9 million), and the expense for potential general and professional liability claims was $29.3 million (US$24.1 million), and included a release of reserves of $5.2 million (US$3.8 million) recorded in the 2015 fourth quarter, following the completion of our annual independent actuarial review, which confirmed the adequacy of our 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. Our last independent actuarial review was conducted at the end of the 2016 second quarter, and the next one will be completed at the end of 2016. Assumptions underlying the determination of the liability are limited by the uncertainty of predicting future events and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; trends in claims along with unique and identifiable settlements; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation. Therefore, management's estimate of the accrual for general and professional liability claims is significantly influenced by assumptions that are subject to judgement by management and the actuary, which may cause the expense to fluctuate significantly from one reporting period to another. Differences between the ultimate claims costs and our historical expense for loss and actuarial assumptions and estimates could have a material adverse effect on our business, operating results and financial condition.

Most of the risks that Extendicare self-insures are long-term in nature, and accordingly, claim payments for any particular policy year occur over a long period of time. However, management estimates and allocates a current portion of the accrual for self-insured liabilities on the statement of financial position. As at June 30, 2016, management estimated that approximately $32.7 million of the accrual for self-insured general and professional liabilities will be paid within the next year. The timing of payments is not directly within management's control; therefore, estimates could change in the future.

Within our Bermuda-based captive insurance company, we hold investments sufficient to support the accrual for self-insured liabilities and to meet the required statutory solvency and liquidity ratios. These invested funds are reported in other assets and totalled $150.6 million (US$116.6 million) as at June 30, 2016, compared to $176.8 million (US$127.7 million) as at December 31, 2015. Subsequent to June 30, 2016, the Company released US$5.0 million of the Captive's funds held for investment to be available as cash for operations. Management believes there are sufficient invested funds held to meet estimated current claims payment obligations.

LONG-TERM DEBT

Continuity of Long-term Debt

The following summarizes the changes in the carrying amounts of long-term debt for the six months ended June 30, 2016, and the 2015 year.

	Six months ended June 30, 2016		**Year 2015**	
(millions of dollars)	**Total**	**Continuing**	**Discontinued**	**Total**
Long-term debt at beginning of year, prior to financing costs	**461.6**	481.1	785.7	1,266.8
Issue of long-term debt				
Construction loans	**2.3**	–	–	–
Bridge Loan	**–**	80.0	–	80.0
Notes payable/other	**–**	–	83.3	83.3.
Repayment of long-term debt	**(10.5)**	(20.3)	(8.1)	(28.4)
Repayment of Bridge Loan	**–**	(80.0)	–	(80.0)
Accretion of convertible debentures	**0.4**	0.8	–	0.8
Change due to period-end foreign exchange rate	**–**	–	61.0	61.0
U.S. Sale Transaction	**–**	–	(921.9)	(921.9)
	453.8	461.6	–	461.6
Financing costs at end of period	**(7.3)**	(7.5)	–	(7.5)
Long-term debt at end of period	**446.5**	454.1	–	454.1
Less: current portion	**(46.7)**	(25.4)	–	(25.4)
	399.8	428.7	–	428.7

Long-term debt totalled $446.5 million as at June 30, 2016, compared with $454.1 million as at December 31, 2015, representing a decline of $7.6 million primarily due to scheduled debt repayments, partially offset by a $2.3 million draw on the construction loans, accretion of the convertible debentures and amortization of financing costs.

Details of the components, terms and conditions of long-term debt are provided in *note 9* of the unaudited interim condensed consolidated financial statements. Extendicare and its subsidiaries are in compliance with all of their respective financial covenants as at June 30, 2016.

Long-term Debt Maturities and Weighted Average Interest Rates

Management has limited the amount of debt that may be subject to changes in interest rates, and all but $2.3 million of the long-term debt that was outstanding at June 30, 2016, was at fixed rates. The following table summarizes key metrics of our consolidated long-term debt as at June 30, 2016, and December 31, 2015.

	June 30, 2016	December 31, 2015
Weighted average interest rate of long-term debt outstanding	**5.5%**	5.5%
Weighted average term to maturity of long-term debt outstanding	**8.5 yrs**	9.0 yrs
Weighted average term to maturity of long-term debt outstanding, excluding finance lease obligations	**7.9 yrs**	8.4 yrs
Trailing twelve months consolidated interest coverage ratio (1)	**5.4 X**	3.7 X
Trailing twelve months consolidated interest coverage ratio, excluding Bridge Loan finance costs of $2.2 million (1)	**5.4 X**	4.1 X
Debt to Gross Book Value (GBV)		
Total assets (carrying value)	**944,455**	1,026,947
Accumulated depreciation on property and equipment	**193,558**	198,183
Accumulated amortization on other intangible assets	**5,811**	5,751
GBV	**1,143,824**	1,230,881
Debt (2)	**456,814**	465,060
Debt to GBV	**39.9%**	37.8%

(1) Interest coverage is defined as Adjusted EBITDA divided by net interest (interest expense before reduction of capitalized interest, net of interest revenue).
(2) Debt includes convertible debentures at face value of $126.5 million, and excludes finance costs.

CONTRACTUAL OBLIGATIONS

The table below provides summary information relating to the contractual obligations as at June 30, 2016. Due to the uncertainty as to the timing of payments to be made with respect to certain obligations, the table excludes our accrual for U.S. self-insured liabilities of $116.1 million and our decommissioning provisions of $8.0 million. In addition, the table excludes our defined benefit pension plan obligations, which are described more fully below.

(millions of dollars)	Total	To the end of 2016	2017	2018	2019	2020	After 2020
Canadian Operations							
Convertible debentures (at face value)	**126.5**	–	–	–	126.5	–	–
Long-term debt	**237.6**	15.7	31.8	18.6	9.7	54.1	107.7
Finance lease obligations	**92.6**	2.9	6.1	6.5	7.0	7.5	62.6
Operating lease obligations	**8.2**	1.6	2.7	2.1	1.6	0.2	–
Purchase obligations	**79.3**	23.0	43.8	12.5	–	–	–
U.S. Continuing Operations (1)							
Finance lease obligations	**0.1**	–	0.1	–	–	–	–
	544.3	43.2	84.5	39.7	144.8	61.8	170.3

(1) Obligations denominated in U.S. dollars are translated to Canadian dollars at a rate of 1.2917.

Defined Benefit Pension Plan Obligations

The contractual obligations table excludes our defined benefit pension plan obligations. The accrued benefit liability on our statement of financial position as at June 30, 2016, was $38.2 million (2015 – $40.9 million). We currently have defined benefit registered and supplementary plans covering certain executives, both of which have been closed to new entrants since 2000. The registered defined benefit plan was in an actuarial deficit of $2.7 million with plan assets of $5.3 million and accrued benefit obligations of $8.0 million as at June 30, 2016 (2015 – an actuarial deficit of $2.5 million with plan assets of $5.4 million and accrued benefit obligations of $7.9 million). The accrued benefit obligations of the supplementary plan were $35.5 million as at June 30, 2016 (2015 – $38.4 million). We do not set aside assets in connection with the supplementary plan and the benefit payments will be paid from cash from operations. The benefit obligations under the supplementary plan are secured by a letter of credit totalling $40.4 million as at June 30, 2016 (2015 – $42.8 million). This letter of credit renews annually based on an actuarial valuation of the pension obligations, and declined to $40.4 million effective May 1, 2016. The annual benefit payments under the supplementary pension plan to be funded from cash from operations over the next five years are expected to be in the range of $2.2 million to $2.5 million, and the annual contributions to the registered pension plan over the next five years are expected to be less than $0.1 million. Since the majority of our accrued benefit obligations represent our obligation under our non-registered supplementary plan, which is not required to be funded, changes in future market conditions are not expected to have a material adverse effect on our cash flow requirements with respect to our pension obligations, or on our pension expense.

Future Liquidity and Capital Resources

As at June 30, 2016, Extendicare's consolidated cash on hand totalled $38.6 million, of which $35.8 million was held by our Canadian operations, and $2.8 million was held by our U.S. operations. Cash on hand at June 30, 2016, excludes restricted cash of $4.5 million related primarily to the retirement development projects, funds held in escrow of $7.8 million (US$6.0 million) to secure certain obligations assumed in connection with the U.S. Sale Transaction, and $150.6 million (US$116.6 million) of investments held by our Captive to support the accrual for U.S. self-insured liabilities of $116.1 million (US$89.9 million). Subsequent to June 30, 2016, US$5.0 million of the Captive's funds were released from investments held for self-insured liabilities to cash available for operations.

The Company has acquired six retirement communities since October 2015, for cash of approximately $139 million. Subsequent to June 30, 2016, the Company secured financing in the aggregate of $56.3 million on three of the retirement communities, representing approximately 71% of their acquisition costs. The Company intends to seek financing on the remaining three once stabilized occupancy is achieved. For further information refer to the discussion under the heading "Significant 2016 Events and Developments – Expansion into Private-pay Retirement Sector".

In addition, construction financing of up to $51.4 million has been secured on the first three retirement projects under development at 63% of the estimated costs, and similar financing arrangements are anticipated for the fourth project. The anticipated cost to develop these retirement communities of approximately $113.5 million, of which approximately $16.9 million has been spent to date, includes all amounts through the lease-up period until stabilized NOI is achieved, as well as an implied cost of capital.

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

RELATED PARTY TRANSACTIONS

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

RISKS AND UNCERTAINTIES

There are certain risks inherent in an investment in securities and 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 Company's 2015 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 "Significant 2016 Events and Developments" and "Other Significant Developments".

ACCOUNTING POLICIES AND ESTIMATES

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, 2015, contained in the Company's 2015 Annual Report. The disclosures in such report have not materially changed since that report was filed, and to the extent there have been any changes in management's estimates, they are discussed under the headings "Significant 2016 Events and Developments" and "Other Significant Developments".

Management considers an understanding of Extendicare's accounting policies to be essential to an understanding of its financial statements because their application requires significant judgement and reliance on estimations of matters that are inherently uncertain. The following are subject to judgements and key sources of estimation uncertainty that the Company believes could have the most significant impact on the amounts recognized in the consolidated financial statements: the valuation of purchase price components for acquisitions; the valuation of deferred consideration; the determination of the recoverable amount of cash generating units subject to an impairment test; the valuation of indemnification provisions; the valuation of the U.S. self-insured liabilities; the assessment of contingencies; the valuation of financial assets and liabilities; the valuation of share-based compensation; and the 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 progresses; accordingly, actual results could differ from those estimated.

Future Changes in Accounting Policies

The following new standards, amendments to standards and interpretations, are effective for future annual periods, and have not been applied in preparing the financial results for the period ended June 30, 2016. These accounting standards are summarized below, and are more fully described in *note 3* of the unaudited interim condensed consolidated financial statements.

LEASES

On January 16, 2016, the International Accounting Standards Board (IASB) published IFRS 16 "Leases". The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained. IFRS 16 supersedes IAS 17 "Leases" and related interpretations and is effective for periods beginning on or after January 1, 2019, with earlier adoption permitted if IFRS 15 "Revenue from Contracts with Customers" has also been applied. The Company is currently assessing the potential impact of this standard on its consolidated financial statements.

FINANCIAL INSTRUMENTS

In July 2014, the IASB issued IFRS 9 "Financial Instruments" (IFRS 9 (2014)), which replaces IAS 39 "Financial Instruments: Recognition and Measurement". IFRS 9 (2014) introduces new requirements for the classification and measurement of financial assets, and changes to financial liabilities, amends the impairment model for 'expected credit loss', and introduces a new general hedge accounting standard that aligns hedge accounting more closely with risk management. This standard will be effective for annual periods beginning on or after January 1, 2018, and will be applied retrospectively with some exemptions. Early adoption is permitted, and restatement of prior periods is not required. The Company is currently assessing the potential impact of this standard on its consolidated financial statements.

REVENUE RECOGNITION

In May 2014, the IASB issued IFRS 15 "Revenue from Contracts with Customers". The new standard provides a comprehensive framework for recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the standard on leases, insurance contracts and financial instruments. IFRS 15 becomes effective for annual periods beginning on or after January 1, 2018, and is to be applied retrospectively. Early adoption is permitted. The Company is currently assessing the potential impact of the new standard on its consolidated financial statements.

Disclosure Controls and Procedures and Internal Control over Financial Reporting

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

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

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

Except as noted below, there were no changes in the Company's ICFR during the 2016 second quarter that have materially affected, or are reasonably likely to materially affect, the Company's ICFR.

Prior to June 30, 2016, in accordance with the provisions of National Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings*, management, including the CEO and CFO, had limited the scope of the design of the Company's DC&P and ICFR to exclude controls, policies and procedures of the home health care business acquired on April 30, 2015, referred to as the Home Health Acquisition.

The Home Health Acquisition's contribution to the Company's consolidated financial statements for the three and six months ended June 30, 2016 was approximately 19.3% and 19.1% of consolidated revenue from continuing operations, respectively, and approximately 14.7% and 13.9% of consolidated net operating income from continuing operations, respectively. Additionally, at the time of the acquisition, the current assets and current liabilities of the acquired operations were approximately 6% and 5% of consolidated current assets and liabilities, excluding those designated as held for sale, respectively, and its long-term assets and long-term liabilities were approximately 13% and less than 1% of consolidated long-term assets and long-term liabilities, respectively.

The scope limitation is primarily based on the time required to assess the DC&P and ICFR of the operations of the Home Health Acquisition in a manner consistent with the Company's other operations. The assessment on the design effectiveness of DC&P and ICFR was completed at the end of the 2016 second quarter and the assessment of operating effectiveness is on track to be completed by the end of the 2016 fourth quarter. Further details related to the Home Health Acquisition are disclosed under the heading "Other Significant Developments – 2015 Home Health Acquisition" and in *note 4* of the unaudited interim condensed consolidated financial statements.