



August 2, 2007

***Extendicare Real Estate Investment Trust Unitholders' Quarterly Report – June 30, 2007***

Dear Unitholder:

On August 2, 2007, Extendicare Real Estate Investment Trust ("Extendicare REIT" or the "REIT") announced its results for the second quarter of 2007.

Highlights for the 2007 second quarter results and other current activities include:

- EBITDA of \$54.0 million;
- FFO from continuing operations of \$24.4 million (\$0.35 per diluted unit);
- Strong Medicare census of 18.9%; U.S. EBITDA margin of 13.1%;
- Acquires 99-bed SNF and 56-unit ALF in Wisconsin;
- Declares August distribution of \$0.0925 per unit;
- Douglas J. Harris appointed interim CFO; and
- Extendicare REIT subject to SIFT tax.

The results of the second quarter are a direct reflection of Extendicare REIT successfully implementing its business plan which includes continued operational improvement, particularly with respect to Medicare admissions in our U.S. operations. With the completion of the recent financing and closure on the sale of the legacy investment in Crown Life, the REIT has substantial financial flexibility, enabling us to continue growing the portfolio. Please refer to the attached Unitholders' Report for further details of our financial results.

**Interim Chief Financial Officer Appointed**

Douglas J. Harris has been appointed interim Chief Financial Officer while the REIT conducts a search to find a permanent replacement for the late Richard Bertrand. Mr. Harris has been with the Extendicare group since 1981 in various capacities, most recently as Vice President and Controller of Extendicare Health Services, Inc. (EHSI).

**Tendercare Acquisition Update**

The acquisition of Tendercare (Michigan) Inc. (Tendercare) remains on track to close in the fourth quarter of 2007. As previously indicated, a portion of Tendercare's debt was financed by the U.S. Department of Housing and Urban Development (HUD) which has a very complex process when it comes to ownership transfer. Management has met with the HUD office responsible for Tendercare, and anticipates being able to close the transaction within the previously stated timeline. Through the five months ended May 2007, Tendercare's portfolio occupancy and Medicare census was 84.6% and 15.2%, respectively.

The transaction is structured to be payable with cash of US\$122.5 million plus the assumption of US\$80.0 million of debt, prior to working capital and the cost of the two development projects. Management will determine the optimum financing of the acquisition prior to closing.

## **Extendicare REIT Tax Status**

On June 12, 2007, the Canadian House of Commons passed Bill C-52, which includes proposals to amend the income tax rules applicable to certain publicly traded entities that are specified investment flow-through trusts or partnerships (SIFTs). In order for Extendicare REIT to qualify for an exemption from the proposed SIFT tax until the earlier of 2011 or the first taxation year after 2006 in which the REIT exceeds “normal growth” as determined under published growth guidelines, the trust units of Extendicare REIT (the “REIT Units”) must have been listed on the Toronto Stock Exchange (TSX) on, or prior to, October 31, 2006.

Although all matters relating to the conversion of Extendicare Inc. (Extendicare) into Extendicare REIT had been completed on October 31, 2006, it was not clear whether the REIT Units were “listed” on the TSX on October 31, 2006. Based on management’s efforts to date, including discussions with the Canada Revenue Agency, all indications are that Extendicare REIT will not qualify for the exemption.

The Board of Trustees had already considered the income tax proposals of Bill C-52 in its determination of distributions. Therefore, if Bill C-52 is enacted in its current form, the amount of the current \$0.0925 monthly distributions is not expected to decrease.

## **Sale of Crown Life**

As previously announced, Extendicare completed the sale of its approximate 35% equity interest in Crown Life Insurance Company (Crown Life) on July 5, 2007. In total, Extendicare received cash of \$81.7 million and securities valued at approximately \$3.6 million. The cash payment from Canada Life for the Crown Life shares is subject to a post closing adjustment to be determined within 75 days after closing. The final sale of the investment in Crown Life, including post closing adjustments and the recognition of a liability for specified contingent claims will be recognized in the third quarter of 2007.

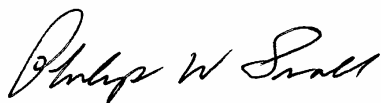
## **Other Items**

On August 1, 2007, EHSI acquired a Wisconsin assisted living facility (56 units) for cash of US\$5.5 million.

EHSI has signed a purchase and sale agreement to acquire a 99-bed skilled nursing facility in Wisconsin for cash of US\$7.5 million, which is expected to close in the fourth quarter of 2007.

Going forward, Extendicare REIT’s key business goals are to stay focused on our core values of providing quality care to our residents, provide an energizing work environment for our employees and create long-term value for our unitholders.

Sincerely,



Philip W. Small  
President and  
Chief Executive Officer

*Information provided by Extendicare REIT from time to time, including this report, contains or may contain forward-looking statements concerning anticipated financial events, results, circumstances, economic performance or expectations with respect to the REIT and its subsidiaries, including its business operations, business strategy, and financial condition. Forward-looking statements can be identified because they generally contain the words “expect”, “intend”, “anticipate”, “believe”, “estimate”, “plan” or “objective” or other similar expressions. Forward-looking statements reflect management’s beliefs and assumptions and are based on information currently available, and the REIT assumes no obligation to update any forward-looking statement. These statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of the REIT to differ materially from those expressed or implied in the statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on the REIT’s forward-looking statements. Further information can be found in the disclosure documents filed by Extendicare REIT with the securities regulatory authorities, available at [www.sedar.com](http://www.sedar.com) and on the REIT’s website at [www.extendicare.com](http://www.extendicare.com).*



**UNITHOLDERS' QUARTERLY REPORT**

**Six Months Ended June 30, 2007**

# MANAGEMENT'S DISCUSSION AND ANALYSIS

*August 2, 2007*

## **Basis of Presentation**

The consolidated financial results include those of Extencicare Real Estate Investment Trust and its subsidiaries. References to "Extencicare REIT" or the "REIT" in this report mean Extencicare Real Estate Investment Trust alone or together with its subsidiaries, as the context requires. The direct ownership and operation of the senior care facilities and ancillary businesses is conducted by the subsidiaries of the REIT. The REIT itself is not a provider of services or products.

Extencicare REIT is the successor in interest to Extencicare Inc. ("Extencicare" or the "Company") resulting from the conversion of Extencicare to a real estate investment trust on November 10, 2006 pursuant to a plan of arrangement (the "Arrangement"). Extencicare REIT is an unincorporated, open-ended limited purpose trust established under the laws of the Province of Ontario pursuant to a deed of trust, dated September 11, 2006, as amended and restated on October 28, 2006 (the "Deed of Trust"). Extencicare REIT trades on the Toronto Stock Exchange (TSX) under the symbol "EXE.UN". The conversion has been accounted for as a continuity of interest, and, accordingly, the consolidated financial statements of the REIT reflect the consolidated financial position, results of operations and cash flows as if the REIT had always carried on the business formerly carried on by Extencicare. Commencing with the year ended December 31, 2006, comparative information for the REIT relating to periods prior to the conversion is that of its predecessor, Extencicare Inc.

The Arrangement included the distribution of Assisted Living Concepts, Inc. (ALC) to Extencicare's shareholders. As a result, the financial results for 2006 and prior periods reflect ALC as a discontinued operation. As well, Extencicare conducted a number of pre-Arrangement transactions to position itself for the Arrangement. References to the "Reorganization" in this document are to the Arrangement completed on November 10, 2006, and the pre-Arrangement transactions as described under the heading "Significant Developments – 2006 Reorganization".

This Management's Discussion and Analysis of Results of Operations and Financial Position (MD&A) describes the REIT's business, the business environment, the principal factors affecting the results of operations, liquidity and capital resources, and the critical accounting policies of the REIT that will help the reader understand the consolidated financial results. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other elements may or may not occur which could affect the REIT in the future. This MD&A should be read in conjunction with Extencicare REIT's unaudited interim consolidated financial statements for the six months ended June 30, 2007, and the notes thereto, together with the MD&A and the audited consolidated financial statements and accompanying notes for the year ended December 31, 2006 found in the REIT's 2006 Annual Report. Extencicare REIT's accounting policies are in accordance with Canadian generally accepted accounting principles (GAAP) of The Canadian Institute of Chartered Accountants (CICA). All dollar amounts are in Canadian dollars unless otherwise indicated. Except as otherwise specified, references to years indicate the fiscal year ended December 31, 2006, or December 31 of the year referenced.

Certain comparative figures have been reclassified for discontinued operations identified in 2007.

## **Executive Overview**

Extencicare REIT, through its wholly owned subsidiary operating entities, is a major provider of long-term care and related services in North America. Extencicare operates 234 senior care facilities largely composed of nursing homes in North America, with capacity for 26,851 residents.

The REIT's wholly owned U.S. subsidiary, Extencicare Health Services, Inc. and its subsidiaries (collectively "EHSI"), operates nursing and assisted living facilities in the United States. EHSI offers a continuum of health care services, including nursing care, assisted living and related medical specialty services, such as subacute care and rehabilitative therapy on an inpatient and outpatient basis.

The REIT's wholly owned subsidiary, Extencicare (Canada) Inc. and its subsidiaries (collectively "ECI"), operates nursing and retirement centres in Canada, and also manages a chronic care hospital unit in Ontario. ECI is a major provider of home health care in Canada through its ParaMed Home Health Care (ParaMed) division.

At June 30, 2007, Extendicare operated 234 senior care facilities with capacity for 26,851 residents (December 31, 2006 – 234 facilities with capacity for 26,836; June 30, 2006 – 438 facilities with capacity for 34,784 residents, which included 206 ALC facilities). The number of facilities operated at June 30, 2007, has fluctuated during the first six months of 2007 due to the designation in the 2007 first quarter of one Ohio nursing facility (175 beds) as discontinued and the acquisition of a 191-bed Wisconsin nursing home in May 2007. In addition, the operational capacity at other facilities was adjusted during 2007.

EHSI has a significant presence (more than 15% of its resident capacity) in each of Pennsylvania and Ohio. As well, ECI's senior care facilities have a significant presence in Ontario, where 77% of its residents are served. EHSI's average occupancy from continuing nursing home operations was 90.1% in the first half of 2007 compared to 91.9% in the first half of 2006, and to 91.3% for the 2006 year. ECI's average occupancy in its senior care facilities was 98.0% in the first half of 2007 compared to 97.9% in the first half of 2006, and to 98.1% for the 2006 year.

Extendicare remains committed to its core senior care operations, while continuing to grow its complementary long-term care services. Nursing and assisted living centre revenue represented approximately 89% of Extendicare's revenue from continuing operations for the first half of 2007, as well as for the 2006 year. Management will continue its strategy to grow the business through selective acquisitions and new development projects.

The principal elements of Extendicare's business strategy are to: provide quality, clinically-based services; strengthen both Medicare and total average daily census (ADC); increase market share of Canadian home health care operations; improve operating cash flow; actively improve its asset portfolio through renovation, expansion or acquisition, or where appropriate through disposal of underperforming facilities; expand non-government based revenue sources, thereby decreasing the level of risk and reliance on government funding; diversify within the long-term care industry in the areas of rehabilitative clinics and management and consulting services; increase operating efficiency; and manage resident care liability claim settlements.

One of the major factors contributing to the improved performance of the U.S. operations has been management's focus on driving revenue through growth in ADC, particularly Medicare ADC. As noted in previous reports, EHSI has implemented consistent admission practices, has certified all of its nursing facility beds under the Medicare program and implemented routines that commit senior management to focus on census.

In preparation for the January 1, 2006, changes to the Resource Utilization Groupings (RUGs) classifications implemented by the Centers for Medicare & Medicaid Services (CMS), which included the discontinuance of funding under the "RUGs Refinement" enhancements and implementation of nine new RUGs classifications, EHSI refocused its marketing strategies to target residents requiring short-term rehabilitative services and trained its clinical staff to ensure it could accurately assess its residents in accordance with the changes. As a result, though EHSI experienced a decline in census during 2006, it was successful in not only recovering the loss from the RUGs Refinement enhancements, but also increasing its average Medicare rates. Despite the loss of the RUGs Refinement enhancements, EHSI's average Medicare Part A rate increased from US\$362.99 in the 2005 fourth quarter to US\$369.12 in the 2006 third quarter, which was prior to any rate increases. On October 1, 2006, Medicare Part A rates increased by 3.1% as part of the annual inflationary increase, resulting in EHSI's average Medicare Part A rate increasing to US\$382.78 in the 2006 fourth quarter. In 2007 EHSI's average Medicare Part A rate increased further and averaged US\$388.93 for the 2007 second quarter due to changes in patient mix. For the 2007 second quarter, approximately 37.6% of EHSI's Medicare residents were classified within the nine new high acuity RUGs classifications compared to 37.0% for the 2006 second quarter and to 37.7% in the 2007 first quarter. As well, the percentage of therapy residents increased to 85.7% in the 2007 second quarter from 83.7% in the 2006 second quarter.

Revenue by Payor Source <i>(U.S. nursing facilities)</i>	2007 Quarters		2006 Quarters				2005 Quarters			
	Q1	Q2	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Average Medicare Part A rate (US\$)	<b>387.95</b>	<b>388.93</b>	367.64	369.48	369.12	382.78	340.47	343.08	344.78	362.99

The following table provides the quarterly same-facility ADC for Medicare patients and total residents served in EHSI's nursing homes for 2007 and 2006.

U.S. Nursing Homes <i>(same-facility basis)</i>	2007 Quarters		2006 Quarters			
	Q1	Q2	Q1	Q2	Q3	Q4
Medicare ADC	2,379	2,347	2,378	2,293	2,230	2,296
Total ADC	12,515	12,453	12,694	12,565	12,537	12,557

Due to the refocus of EHSI's marketing of short-term rehabilitative residents, EHSI's total U.S. nursing home census on a same-facility basis declined by 0.9% in the 2007 second quarter to 12,453 from 12,565 in the 2006 second quarter. EHSI's Medicare ADC on a same-facility basis improved to 2,347 in the 2007 second quarter compared to 2,293 in the 2006 second quarter. EHSI's Medicare ADC in the 2007 second quarter decreased by 1.3% from 2,379 in the 2007 first quarter. Medicare admissions usually begin to decline in the second quarter and are generally at their lowest in the summer months, as there tends to be fewer elective surgeries performed, which affects admissions of EHSI's short-term stay patients.

For further details on the significant transactions affecting the 2007 results, refer to "Significant Developments", and for an analysis of the REIT's financial results, refer to the discussions under "Summary of Quarterly Results", "2007 Second Quarter Results" and "2007 Six Months Results".

## Critical Accounting Policies and Estimates

The REIT's consolidated financial statements have been prepared in accordance with Canadian GAAP. For a full discussion of the REIT's critical accounting policies and estimates, readers should refer to the MD&A of the REIT's 2006 Annual Report. The disclosures in such report have not materially changed since that report was filed; however, to the extent there have been changes in accounting policies or management's estimates, they are discussed under "Significant Developments" and under "Changes in Accounting Policies". Management considers an understanding of the REIT's accounting policies to be essential to an understanding of the REIT's financial statements because their application requires significant judgement and reliance on estimations of matters that are inherently uncertain. There is measurement uncertainty relating to the accounting policies applied to: revenue recognition and the valuation of accounts receivable; the measurement of acquired assets and assumed liabilities in business combinations; the valuation of assets and determination of asset impairment; the valuation of conditional asset retirement obligations; the accrual for self-insured liabilities; and the valuation for future tax assets and liabilities.

## Significant Developments

The following have had a significant effect on the financial results of Extencicare REIT for the first half of 2007 in comparison to the same period for 2006.

### 2006 Reorganization

On November 10, 2006, Extencicare completed the Arrangement that involved the distribution of ALC to the shareholders of Extencicare and the conversion of Extencicare into a Canadian real estate investment trust. Extencicare REIT, through its subsidiary operating entities, owns and continues to operate Extencicare's U.S. and Canadian nursing home businesses, a smaller number of assisted living facilities than were operated by Extencicare prior to November 10, 2006, and related businesses of Extencicare.

Pursuant to the terms of the Arrangement, holders of Subordinate Voting Shares of Extencicare ultimately received for each share (a) one Class A share of ALC, and (b) one unit of Extencicare REIT (REIT Unit) or, one Class B limited partnership unit (Exchangeable LP Unit) of Extencicare Limited Partnership (Extencicare LP); and holders of Multiple Voting Shares of Extencicare ultimately received for each share (a) one Class B share of ALC, and (b) 1.075 REIT Units or, 1.075 Exchangeable LP Units. The Exchangeable LP Units are not listed on a stock exchange, they are exchangeable for REIT Units at the option of the holder on a one-for-one basis, are entitled to vote with the holders of REIT Units pursuant to the Special Voting Units of the REIT, and are intended to be, to the greatest extent practicable, the economic equivalent of the REIT Units.

Prior to the implementation of the Arrangement, Extencicare carried out certain pre-Arrangement transactions including:

- the transfer by EHSI to ALC of 29 assisted living properties that were formerly owned and operated by EHSI;
- other cash and non-cash capital contributions to ALC by EHSI;

- the transfer by EHSI of the shares of ALC to Extencicare;
- the prepayment by EHSI of all amounts owing by it under its existing term loan and credit facility, its 9.5% Senior Notes due July 1, 2010, (the "2010 Notes"), its 6.875% Senior Subordinated Notes due May 1, 2014, (the "2014 Notes") with the proceeds from the completion of a commercial mortgage backed securitization transaction and a new revolving line of credit;
- the termination by EHSI of its interest rate swap and cap agreements relating to the 2010 Notes and 2014 Notes; and
- the redemption of its preferred shares.

#### **Transfer of ALC Shares by EHSI to Extencicare and Distribution to Extencicare's Shareholders**

On November 10, 2006, all of the shares of ALC were transferred by EHSI to Extencicare at fair market value for U.S. tax purposes. Management has estimated income taxes payable of \$115.9 million (US\$102.5 million) in connection with the gain arising on the transfer of ALC by EHSI to Extencicare. Management believes the final determination of the capital gains tax will be based on the volume weighted average trading price of the ALC Class A Shares on its first day of trading, which was US\$8.00 on November 10, 2006. The U.S. Internal Revenue Service is not obliged to accept management's methodology for determining the fair market value of ALC. Each one dollar increase or decrease in the price of the ALC Class A Shares used to determine the fair market value of ALC for U.S. income tax purposes would result in a corresponding increase or decrease of approximately US\$30.0 million in EHSI's U.S. income tax liability.

Subsequent to the transfer of all of the shares of ALC by EHSI to Extencicare, the shares of ALC were distributed by Extencicare to its shareholders on November 10, 2006. The distribution was reflected as a charge to retained earnings of \$476.5 million.

#### **Proposed Canadian Federal Income Tax on Income Trusts**

On October 31, 2006, the Minister of Finance (Canada) announced the Tax Fairness Plan for Canadians (the "Tax Fairness Plan") in consequence of which the income tax rules applicable to certain publicly traded entities that are specified investment flow-through trusts or partnerships (SIFTs) and their unitholders will be significantly altered. The proposals in the Tax Fairness Plan to amend the Income Tax Act (Canada) (the "SIFT Proposals") are currently reflected in Bill C-52, which was passed by the House of Commons on June 12, 2007. On December 15, 2006, the Department of Finance (Canada) released growth guidelines (the "Growth Guidelines") for SIFTs, which have been incorporated into the SIFT Proposals. This discussion assumes that the SIFT Proposals will be enacted in their current form; however, no assurances can be given that this will be the case.

The SIFT Proposals are not applicable to a "real estate investment trust" (as defined in the SIFT Proposals) that meets certain specified conditions relating to the nature of its income and investments. Extencicare REIT does not meet these conditions and will not qualify for this exception and will be a SIFT for purposes of the SIFT Proposals.

Under the SIFT Proposals, an income trust that is a SIFT will be subject to tax in respect of certain income that is distributed to its unitholders, at rates that are substantially equivalent to the general corporate tax rate applicable to Canadian corporations. Distributions in respect of which this tax is payable will be treated in the same manner as taxable dividends from a taxable Canadian corporation in the hands of unitholders and will be eligible for the enhanced dividend tax credit. Distributions paid by a SIFT as returns of capital will not be subject to the distribution tax contained in the SIFT Proposals. Approximately 73% of Extencicare REIT's distributions in 2006 were characterized as non-taxable returns of capital in Extencicare REIT's indirect investment in its subsidiaries. Management believes that it is likely that approximately 70% of Extencicare REIT's distributions in 2007 will also be characterized as non-taxable returns of capital. The adjusted cost base of the REIT Units held by a unitholder will generally be reduced by such non-taxable portion of distributions that are made to the unitholder. Extencicare REIT believes that in 2007 any impact of the SIFT Proposals on its unitholders will be significantly reduced due to the large portion of distributions that are expected to be returns of capital. No assurance can be given that the composition of distributions by Extencicare REIT for tax purposes will not be changed from that described above. Any change in such composition of the REIT's distributions will affect its unitholders' after tax return.

The SIFT Proposals will apply to the 2007 and subsequent taxation years of a trust that is a SIFT unless the trust would have been a "SIFT trust" (as defined in the SIFT Proposals) on October 31, 2006, if the SIFT Proposals had been in force on that date (the "Existing Trust Exemption"). For trusts that qualify for the Existing Trust Exemption, the SIFT Proposals only apply commencing with the earlier of the trust's 2011 taxation year or the first taxation year of the trust after 2006 in which it exceeds "normal growth" as determined under the Growth Guidelines.

In order for Extencicare REIT to qualify for the Existing Trust Exemption the REIT Units must have been listed on the TSX on, or prior to, October 31, 2006. Although all matters relating to the conversion of Extencicare into Extencicare REIT had been completed on October 31, 2006, it was not clear whether the REIT Units were "listed" on the TSX on October 31, 2006. As a result, Extencicare REIT applied to the Canada Revenue Agency (CRA) for an advance income tax ruling that it qualifies for the Existing Trust Exemption. Based on discussions with officials of the CRA, during which those officials indicated that they have concluded their review and have determined that Extencicare REIT does not qualify for the Existing Trust Exemption, Extencicare REIT has decided to withdraw its application for the advance income tax ruling.

Since Bill C-52 was substantially enacted in June 2007, Extencicare REIT has recorded a provision for the additional SIFT tax beginning with its 2007 second quarter results. Based on Extencicare REIT's current structure, operations and current level of return of capital, its understanding of the SIFT Proposals and certain assumptions, management recorded a provision of \$2.3 million, or \$0.03 per diluted unit, of which approximately \$1.1 million related to the 2007 first quarter.

The current policy of each of Extencicare REIT and Extencicare LP is to pay distributions of \$0.0925 per REIT Unit and per Exchangeable LP Unit to holders thereof on a monthly basis. The declaration and payment of future distributions is subject to the discretion of the Board of Trustees and will be dependent upon a number of factors, including results of operations, requirements for capital expenditures and working capital, future financial prospects of Extencicare REIT and its subsidiaries, debt covenants and obligations, and other factors deemed relevant by the Board of Trustees. If the SIFT Proposals are enacted, the amount of the monthly distributions is not expected to decrease.

## Financings

### 2007

On January 19, 2007, ECI completed \$26.3 million of Canada Mortgage and Housing Corporation (CMHC) financing secured by three of its Canadian nursing facilities. The three loans have 10-year terms with weighted average monthly payments amortized over 20 years at 4.67%.

On March 6, 2007, EHSI raised US\$90.0 million from the completion of a second commercial mortgage backed securitization loan due 2012 (the "2012 CMBS Financing"), with a fixed interest rate of 6.79%. The 2012 CMBS Financing has a 5-year term and stipulates monthly payments of interest only for the first three years, and thereafter monthly payments of principal and interest based upon a 25-year amortization period. The 2012 CMBS Financing is collateralized by first mortgages on 14 of EHSI's skilled nursing facilities. The proceeds from the 2012 CMBS Financing were used primarily to cover current taxes payable on the sale of ALC by EHSI to Extencicare.

On June 21, 2007, the REIT completed a public offering of \$115.0 million of 5.70% convertible subordinated unsecured debentures, with a \$19.90 conversion price, due June 30, 2014 (the "2014 Debentures"). The net proceeds from the 2014 Debentures were approximately \$109.3 million, after the payment of issue related costs of approximately \$5.7 million, of which \$49.4 million (US\$46.0 million) was used to repay the balance outstanding under EHSI's revolving line of credit. The balance of the net proceeds will be used to fund future strategic acquisitions and internal growth expenditures, and for other general business purposes.

On June 29, 2007, Extencicare amended its revolving line of credit with Royal Bank of Canada (the "RBC Credit Facility") to increase its availability from \$50.0 million to \$70.0 million. The RBC Credit Facility is due on demand, is secured by 14 Canadian nursing homes, and is guaranteed by certain Canadian operating subsidiaries of Extencicare. It is primarily used to back letters of credit, of which there were \$45.1 million issued and outstanding as at June 30, 2007, to secure Extencicare's pension obligations. On July 5, 2007, the additional availability obtained was used to secure \$18.8 million of letters of credit in connection with the sale of Extencicare's investment in Crown Life Insurance Company (Crown Life) (see "Investment in Crown Life Insurance Company").

### 2006

In October 2006 ECI refinanced a \$9.9 million mortgage that had matured, with CMHC financing, for a term of 10 years at a rate of 4.63%, under a 20-year amortization schedule.

In the fourth quarter of 2006 as part of the Reorganization, EHSI repaid its 2010 Notes in the principal amount of US\$150.0 million, its 2014 Notes in the principal amount of US\$125.0 million, and its term loan and revolving credit facility in the amount of US\$164.9 million with proceeds from the completion on October 16, 2006 of a US\$500.0 million commercial mortgage backed securitization transaction (the "2011 CMBS Financing"). At the same time, EHSI amended its credit facility to provide for borrowings of up to US\$120.0 million (the "Credit Facility"). Proceeds from the financings

were also used to cover prepayment penalties, terminate interest rate lock, swap and cap agreements, and pay related transaction costs.

The 2011 CMBS Financing has a 5-year term, with a fixed interest rate of 6.6525%, with monthly interest only payments for the first three years, and principal and interest payments for the last two years, based upon a 25-year amortization period. The 2011 CMBS Financing is collateralized by a first mortgage on 86 of EHSI's skilled nursing facilities.

Under both the 2011 and 2012 CMBS Financings, EHSI is required to maintain: a consolidated leverage ratio (exclusive of any notes owing to Extencicare REIT and its subsidiaries) of less than 5.5 to 1.0 and a consolidated fixed charge ratio of at least 1.50 to 1.00. If an event of default occurs, the lenders may appoint an interim manager and charge a default rate of interest, and/or foreclose on the mortgages and other collateral securing the loans.

EHSI's Credit Facility has a 3-year term, no required principal repayments, and floating-rate interest based on a pricing grid. The interest rate margins range based upon EHSI's consolidated leverage ratio. The margin over the Eurodollar rate ranges from 1.5% to 2.5%, or 0.5% to 1.5% over the base rate, as applicable. The Credit Facility has 24 skilled nursing facilities as specific collateral and is guaranteed by Extencicare Holdings, Inc. (EHSI's parent company) and EHSI's material domestic subsidiaries. The Credit Facility is used to back letters of credit and for general corporate purposes.

Under the Credit Facility, EHSI is required to comply with various financial covenants, including fixed charge coverage, debt leverage, and tangible net worth ratios. The Credit Facility contains customary covenants and events of default and is subject to various mandatory prepayment and commitment reductions. If an event of default occurs, the lenders may accelerate the maturity of the loans under the Credit Facility, charge a default rate of interest, and/or foreclose on the mortgages and other collateral securing the Credit Facility. EHSI is permitted to make voluntary prepayments at any time under the Credit Facility.

The amount available to be borrowed under EHSI's Credit Facility is the lesser of: (1) 60% of the appraised values of the nursing facilities collateralizing the Credit Facility, or (2) an amount based on the actual net cash flow of these facilities for the last 12 months. The amount available to be borrowed as of June 30, 2007 was US\$97.8 million, of which EHSI had US\$20.4 million securing outstanding letters of credit, leaving the unused portion of the Credit Facility at US\$77.4 million.

## **Acquisitions and Pending Acquisitions**

### **2007**

On January 5, 2007, EHSI completed the acquisition of a nursing facility (111 beds) in Ohio, which it had been operating under a lease arrangement, for cash of \$8.7 million (US\$7.4 million).

In May 2007 EHSI acquired a nursing facility in Milwaukee, Wisconsin (191 licensed beds) for cash of \$2.8 million (US\$2.5 million). EHSI plans to operate the facility as an 80-bed nursing facility and to relocate the remaining beds to another facility.

On August 1, 2007, EHSI acquired a Wisconsin assisted living facility (56 units) for US\$5.5 million in cash.

### *Pending*

On May 9, 2007, EHSI entered into a purchase and sale agreement with the shareholders of Tendercare (Michigan) Inc. and affiliated entities (collectively "Tendercare"), a private nursing home operator in the state of Michigan. Total consideration for the transaction including assumption of debt is expected to be approximately US\$202.5 million, prior to working capital and two projects under development, representing approximately US\$59,000 per operational bed. The transaction is structured to be payable with cash of US\$122.5 million plus the assumption of US\$80.0 million of debt. The acquisition cap rate is approximately 10.0%.

The Tendercare portfolio is comprised of 31 senior care facilities, composed of 29 skilled nursing facilities, one assisted living facility and one rehab hospital representing 3,400 operational beds. As well, Tendercare has two skilled nursing facilities under development that will be acquired by EHSI at cost upon completion. Tendercare's Medicare census was 15.2% and overall nursing home occupancy was 84.6% in the first five months of 2007.

The completion of the acquisition is subject to certain customary regulatory approvals, including approval by the U.S. Department of Housing and Urban Development (HUD). Management has met with the HUD office responsible for

Tendercare and anticipates being able to close the transaction in the fourth quarter of 2007. Management will determine the optimum financing of the acquisition prior to closing.

In July 2007 EHSI entered into an agreement to acquire a 99-bed skilled nursing facility in Milwaukee for cash of US\$7.5 million. The acquisition is expected to close in the fourth quarter of 2007.

## **2006**

In 2006 EHSI acquired the following nursing facilities for cash of \$50.2 million (US\$44.2 million): an Ohio nursing facility it had been leasing (150 beds) on December 11, 2006; three nursing facilities (259 beds) in Kentucky on August 1, 2006; and two nursing facilities (417 beds) in Pennsylvania on March 1, 2006.

## **Construction**

### **United States**

EHSI implemented a construction program in 2003 to expand its existing portfolio of nursing and assisted living facilities. All of the assisted living projects under this construction program formed part of the ALC operations that were distributed. With respect to the expansion of its skilled nursing homes, EHSI completed three additions in the 2006 third quarter, adding capacity for 64 beds.

As of June 30, 2007, EHSI had two construction projects in progress, which are expected to add 110 nursing beds by the end of 2007. The total estimated cost of the projects is US\$13.1 million. Costs incurred through June 30, 2007 on these projects were approximately US\$5.5 million and purchase commitments of US\$6.5 million are outstanding.

### **Canada**

In April 2007 ECI entered into an agreement with the local Regional Health Authority (David Thompson Health Region) to construct a 280-bed continuing care centre in the city of Red Deer, Alberta, which ECI will own and operate. The centre will be part of a seniors' community that will include an independent living housing complex being developed by a third party. The estimated cost of the 280-bed project, net of government grants, is approximately \$36.3 million. ECI is in the process of securing financing for the project.

In October 2006 the Ontario government announced an emergency room wait time strategy that includes the construction of 1,750 new and the replacement of 662 long-term care beds. ECI will compete for new beds based on an evaluation of demand and other factors. ECI has made submissions for a number of the projects. In May 2007, the government announced the results of the first round of request for proposals for three projects representing 352 long-term care beds. ECI was awarded one project for 160 long-term care beds in Kingston, Ontario. Construction of the new Kingston facility is anticipated to begin in May 2008 and to be completed in November 2009. The results of the remaining bids are anticipated by the end of September 2007.

## **Loss (Gain) on Derivative Financial Instruments and Foreign Exchange**

For the first half of 2007, the REIT reported a pre-tax gain of \$17.1 million related to the valuation of derivative financial instruments and foreign exchange gains. In the 2007 second quarter a foreign exchange gain of \$5.5 million was realized from the repayment by the Canadian operations of intercompany borrowings with the U.S. operations from proceeds on the issuance of the 2014 Debentures. The valuation of foreign currency forward contracts entered into by EHSI resulted in a gain of \$11.6 million for the first half of 2007. One of the contracts locks in EHSI's exchange rate to acquire Canadian dollars for US\$4.0 million each month at 1.1141 for a 36-month period that commenced in December 2006 and ends in November 2009. In June 2007, EHSI entered into an additional foreign currency forward contract to cover the 7-month period from December 2009 to June 2010. This contract provides for a range of exchange rates on acquiring Canadian dollars for US\$4.0 million each month, with the floor rate set at 1.00 and the ceiling rate set at 1.1050, and the current exchange rate is applied if it falls between these two rates. As of June 30, 2007, the fair value of the foreign currency forward contracts was an asset of \$6.2 million (US\$5.8 million).

For the first half of 2006, the REIT reported a pre-tax gain of \$0.5 million related to the valuation of interest rate caps, which were subsequently terminated in October 2006.

For the year ended December 31, 2006, the REIT reported a pre-tax charge of \$66.8 million on the valuation of derivative financial instruments and a foreign exchange loss. A foreign exchange loss of \$40.3 million occurred on the net reduction of the U.S. net assets in connection with the Reorganization. The valuation and termination of derivative financial instruments resulted in a loss of \$26.5 million related to: a loss of \$11.8 million on settlement of an interest rate lock agreement that

EHSI entered into in connection with securing the 2011 CMBS Financing; a loss of \$9.5 million related to the valuation and subsequent settlement of EHSI's interest rate swap and cap arrangements; and a loss of \$5.2 million related to the valuation of EHSI's foreign currency forward contract.

### Loss (Gain) from Restructuring Charges, Asset Disposals and Other Items

The REIT reported a pre-tax gain of \$2.2 million for the three and six months ended June 30, 2007, related to the disposal of a non-core asset.

For the three and six months ended June 2006, the REIT reported a pre-tax charge of \$3.8 million and \$5.7 million, respectively, primarily related to restructuring charges associated with the Reorganization. For the year ended December 31, 2006, this amount was \$55.2 million of which \$53.8 million related to the Reorganization.

A summary of the charges booked for the three and six months ended June 2007 and 2006, and for the 2006 year is outlined in the table below on a consolidated and divisional basis.

<i>(millions of dollars)</i>	Three months ended June		Six months ended June		Year
	2007	2006	2007	2006	2006
<b>Consolidated</b>					
Restructuring charges	–	2.8	–	5.0	53.8
Other	2.2	1.0	2.2	0.7	1.3
	2.2	3.8	2.2	5.7	55.2 <sup>(1)</sup>
<b>U.S. Operations</b>					
<b>Restructuring Charges</b>					
Transaction costs of reorganization	–	–	–	–	2.3
Retirement of debt					
Tender and call premiums	–	–	–	–	18.7
Write-off of deferred financing costs	–	–	–	–	10.3
Bond discount written off and foreign exchange	–	–	–	–	3.1
Legal expenses	–	–	–	–	0.9
	–	–	–	–	35.3
<b>Other</b>					
Loss on investment in Omnicare	–	0.4	–	0.1	0.4
Loss related to abandoned assisted living project	–	–	–	–	0.7
Gain on sale of non-core assets	2.2	–	2.2	–	(0.5)
Provision for impairment of U.S. long-lived assets	–	–	–	–	0.1
	2.2	0.4	2.2	0.1	0.7
<b>Total U.S. operations</b>	2.2	0.4	2.2	0.1	36.0
<b>Canadian Operations</b>					
<b>Restructuring charges</b>	–	2.8	–	5.0	18.5
<b>Other</b>					
Gain on sale of non-core assets	–	(0.2)	–	(0.2)	(0.2)
Provision for severance	–	0.8	–	0.8	0.8
	–	0.6	–	0.6	0.6
<b>Total Canadian operations</b>	–	3.4	–	5.6	19.2 <sup>(1)</sup>
	2.2	3.8	2.2	5.7	55.2

<sup>(1)</sup> Does not add due to rounding.

## **Discontinued Operations**

Extencare continually assesses the performance of its asset portfolio, and for those assets that fail to meet operating and financial standards, a decision may be made to dispose of the asset. Assets to be disposed of are recorded at the lower of the carrying value or estimated fair market value after disposal costs. Earnings and associated taxes derived from both divested operations and operations that have been classified for disposition are reported separately within the consolidated statements of earnings as discontinued operations.

As well, the operations of ALC have been accounted for by the REIT as discontinued as a result of the Arrangement.

During the 2007 first quarter, due to poor financial performance, EHSI decided to voluntarily close a 175-bed nursing home in Ohio, and sell the property. EHSI recorded an impairment charge of \$6.0 million (US\$5.1 million) to reduce the property value to US\$0.3 million. The comparative figures presented have been revised to reflect these operations as discontinued. As at June 30, 2007, EHSI had assets held for sale of \$7.5 million (US\$7.0 million) related to four nursing facilities in Texas leased to a third party and one closed nursing facility in Ohio.

Discontinued operations reported a loss of \$3.6 million for the first half of 2007, which included the operations and impairment charge of the Ohio nursing facility, the operations of the leased properties in Texas and a pre-tax recovery of \$0.2 million on the sale of an assisted living property in Texas for \$2.2 million in cash. In addition, EHSI completed the transfer of a closed Wisconsin nursing home to a non-profit organization, with no gain or loss on sale.

For the first half of 2006, discontinued operations reported earnings of \$3.2 million, which included the ALC operations. Earnings from discontinued operations were \$7.7 million for the 2006 year and included the operations of: ALC; other assisted living facilities primarily in Texas and Washington; skilled nursing facilities in Wisconsin, Minnesota and Oregon; and leased properties in Florida and Texas.

## **Investment in Crown Life Insurance Company**

As previously announced, Extencare completed the sale of its approximate 35% equity interest in Crown Life on July 5, 2007. As at June 30, 2007, the carrying value of the investment in Crown Life was \$36.6 million. The final sale of the investment in Crown Life, including post closing adjustments and the recognition of a liability for specified contingent claims will be recorded in the third quarter of 2007.

On June 29, 2007, Extencare received \$45.3 million comprised of a dividend from Crown Life and settlement of a purchase and sale agreement with HARO Financial Corporation of certain securities distributed by Crown Life. On July 5, 2007, a cash payment of \$40.0 million was received from Canada Life Assurance Company (Canada Life) for the shares of Crown Life. In total, Extencare received cash of \$81.7 million and securities valued at approximately \$3.6 million. The cash payment from Canada Life for the Crown Life shares is subject to a post closing adjustment to be determined within 75 days after closing.

Under the Crown Life share sale agreement with Canada Life entered into on June 8, 2007, Extencare remains responsible for certain possible specified contingent claims against Crown Life of up to approximately \$18.8 million and in support of the claims, has delivered letters of credit to Crown Life in such amount. In order to secure the letters of credit, Extencare amended its RBC Credit Facility to increase the availability to \$70.0 million from \$50.0 million. Depending on the type of contingent claim, the letters of credit have various terms ranging from 5 to 15 years. Management estimates that Extencare's aggregate liability for such claims will not exceed \$6.0 million.

## **Update of U.S. Legislative Actions Affecting Revenue**

The majority of Extencare's operations are in the United States where approximately 69% of its revenue was earned in the first half of 2007. EHSI receives payment for its services and products from the federal (Medicare) and state (Medicaid) medical assistance programs, as well as from private payors. Private-pay revenue includes payments from individuals, commercial insurers, health maintenance organizations, preferred provider organizations and other charge-based payment sources, including Blue Cross associations and the Department of Veterans Affairs.

Medicaid rates are generally lower than rates earned from Medicare or private/other sources. Therefore, EHSI considers Quality Mix an important performance measurement indicator, where "Quality Mix" is defined as revenue or census earned from payor sources other than from Medicaid programs. In addition, within Quality Mix, EHSI focuses on short-term stay programs and services in its nursing home operations.

The following table sets forth EHSI's percentage of nursing facility revenue from continuing operations for each of its Medicare, private/other, and Medicaid payor sources, excluding prior period revenue settlement adjustments. Though the annual average Medicare census on a same-facility basis has declined in the past couple of years, the percentage of Medicare revenue has remained at similar levels due to an annual 3.1% increase in rates, an increase in the acuity care levels of Medicare patients served and changes to the RUGs classifications as of January 1, 2006.

Revenue by Payor Source <i>(U.S. nursing facilities)</i>	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2007	2006	2007	2006	2006	2005	2006	2005
Medicare	36.7%	36.1%	36.4%	35.5%	34.3%	34.1%	35.7%	34.9%
Private/other	16.7	16.1	16.8	16.5	16.3	15.7	16.1	15.7
Quality Mix	53.4	52.2	53.2	52.0	50.6	49.8	51.8	50.6
Medicaid	46.6	47.8	46.8	48.0	49.4	50.2	48.2	49.4

### Medicare Funding

Effective January 1, 2006, CMS terminated the funding of the RUGs Refinement enhancements. In conjunction with this change, CMS expanded the 44 RUGs classifications to 53, providing nine new RUGs classifications to reimburse operators for the care provided for medically complex residents who require rehabilitation services and treatment of multiple illnesses. In addition, effective January 1, 2006, CMS also increased RUGs rates in the nursing and therapy components of the case mix index for all 53 RUGs rates. Despite the loss of the RUGs Refinements, EHSI's refocused marketing strategies successfully increased its average daily Medicare Part A rate by 7.1% to US\$372.32 for the 2006 year from US\$347.64 for the 2005 year. This increase included a 3.1% market basket increase effective October 1<sup>st</sup> in each of the years 2005 and 2006. Approximately 35.8% of EHSI's Medicare residents were classified within the nine new high acuity RUGs classifications during 2006, and the percentage of therapy residents increased from 78.5% in the 2005 year to 84.0% in the 2006 year.

In August 2007 CMS announced final regulations and rates for Medicare for fiscal 2008, indicating the implementation of a 3.3% market basket increase, effective October 1, 2007. Based on the average rate for the 2007 second quarter, EHSI estimates the Medicare rate increase will result in a net improvement in its average daily Medicare Part A rate of approximately US\$12.83. Based on EHSI's Medicare ADC for the first six months of 2007, this would equate to additional annual revenue of approximately US\$11.6 million.

The Medicare Part D benefit that arose from the Medicare Prescription Drug Improvement and Modernization Act of 2003 was implemented by CMS effective January 1, 2006, and provides access to prescription drug coverage for Medicare beneficiaries. Medicare Part D is a voluntary drug benefit, except for dually eligible Medicare and Medicaid residents, who must enrol in the program. The program provides a prescription drug benefit through a fee-for-service prescription drug plan, or PDP. For a premium, eligible residents have their drug costs administered through a government contracted PDP provider, who negotiates contracts with the institutional pharmacies, including Omnicare, Inc., or Omnicare, which provides pharmacy services to the majority of EHSI's nursing facilities. Omnicare has contracted with the majority of all PDPs to which EHSI's residents subscribe. To date, as a result of the transition plans put into place by CMS, EHSI has not experienced an increase in its drug costs as a result of these changes. However, EHSI could be faced with incremental drug and administrative costs as PDPs exercise their strategies to manage drug costs on behalf of their subscribers.

Effective January 1, 2006, CMS implemented a cap on Part B therapy services of US\$1,740 per annum for physical and speech therapy, and a second cap of US\$1,740 per annum for occupational therapy. However, the Budget Refinement Act of 2005 established a one-year exception process to the therapy caps for individuals who can prove medical necessity for the therapy. The one-year exception process applies to approximately 35% of EHSI's residents requiring Part B therapy services and therefore there has been no significant reduction in EHSI's Part B therapy revenue. Effective January 2007, the exception process was extended for an additional year.

In November 2006 CMS issued federal regulations regarding procedures and documentation standards for skilled nursing facilities to be reimbursed for blood glucose monitoring. The new regulations require physicians to certify the necessity of each finger stick blood glucose test and document those orders effective January 1, 2007. The new rule will require such considerable effort on physicians and skilled nursing facilities that operators will no longer be able to bill for such procedures. EHSI estimates the loss of revenue from this new regulation was approximately US\$1.6 million during the first half of 2007 and the estimated loss in revenue for the year ending December 31, 2007 is US\$3.6 million.

In February 2007 U.S. President Bush announced his budget recommendations for the fiscal year commencing October 2007. The budget includes recommendations for US\$66 billion and US\$7 billion in Medicare and Medicaid cuts, respectively, over the next five years. The recommended savings that impact long-term care over the next five fiscal years include the following:

- A reduction of 0.65% to the skilled nursing market basket increase. Should this recommendation be approved, the impact to EHSI would be approximately US\$2.1 million per annum based upon the average Medicare census and Medicare Part A rate for the 2006 year.
- A phase-down reduction leading to the elimination of bad debt reimbursement from the Medicare program. On an annual basis, EHSI recovers approximately US\$20.0 million from the Medicare program for unpaid co-payment claims from Medicare beneficiaries who fail to pay their portion of the cost of skilled nursing care.
- A reduction in Medicare rates paid to post-acute inpatient rehabilitative hospitals. Though this will have no direct impact to skilled nursing facilities, it may lead to increased occupancies in skilled nursing facilities.
- The introduction of survey and certification fees to those skilled nursing facilities requiring follow-up surveys as a result of a high level of deficiencies identified in the initial survey. No details were provided to determine the impact of this recommendation, although the additional fees were estimated to be US\$35 million annually for all skilled nursing facilities in the industry.

It will be unlikely that the President's budget will receive a hearing by Congress. Congress is in the process of developing its budget recommendations. The House of Representatives Ways and Means and Energy and Commerce Committees are working on their budget appropriation recommendations for health care issues. Energy and Commerce is focused on the State Children's Health Insurance Program (SCHIP) and will likely deliver a bill that is primarily focused on Medicaid, although it may include an extension of the Part B therapy exception process. The Ways and Means Committee is expected to focus on Medicare issues. They will likely target cuts to the Medicare Advantage (Medicare managed care plans) for reductions, increase the tobacco tax, and cut the current market basket inflators. Therefore, adoption of the President's recommendation is not expected. The extent of the reduction in the Medicare market basket is a critical issue.

With the Senate avoiding any program cuts and the House picking up the burden of making cuts it is likely that a final bill will be negotiated in conference committee later this year.

### **Medicaid Rates**

Each year in July, EHSI receives new annual Medicaid rates in seven of the eleven states where it operates nursing facilities. Only one of these states (Washington) has finalized its July 1, 2007 rates, with an increase of approximately 2.8% exclusive of the impact of changes in provider taxes and the CMI index. For the states' fiscal years beginning July 1, 2006, EHSI estimates that its weighted average Medicaid rate increase, not including the impact of provider tax changes and case mix indices, was approximately 2.7%, compared to approximately 1.4% for fiscal years beginning in 2005. In Washington, EHSI's Medicaid rates increased by 9.9% effective July 1, 2006 as a result of the State updating to current operator costs. The annualized impact of the rate increase to EHSI is estimated at \$4.7 million (US\$4.2 million). In Ohio, the State has implemented a new reimbursement system, and EHSI's rates increased only 0.3% effective July 1, 2006. Pennsylvania has also implemented a new reimbursement system effective July 1, 2006, and EHSI's estimated increase was 1.6%.

Effective January 1, 2006, the State of Indiana implemented a Medicaid rate reduction that amounted to approximately \$2.3 million (US\$2.1 million) per annum of lower revenue to EHSI, and applies to the 18-month period ended June 30, 2007. During this period the Medicaid rate will be adjusted for the impact of submitted cost reports and changes in case mix indices.

Over the past few years, several states in which EHSI operates received approval from CMS for state plan amendments and waivers, which increases the level of federal funding for each state's Medicaid program, and provides nursing facilities with revenue rate increases to offset new or increased state provider taxes.

In December 2006 the Tax Relief and Health Care Act of 2006 established that the state provider tax limit would be reduced from the 6% established by CMS to 5.5% effective January 1, 2008 through December 31, 2011. The limit returns to 6% after 2011; however, this limit cannot be changed by CMS regulations in the future. The change does not have a material impact on future revenue, but it does limit the risk for reduced Medicaid rates to the level of funding provided through provider tax funding.

## **Update of Canadian Legislative Actions Affecting Revenue**

The fees charged by ECI for its Canadian nursing centres and home health care services are regulated by provincial authorities. Accordingly, provincial programs fund a substantial portion of these fees, with the remainder paid by individuals. Ontario is ECI's largest market for both its long-term care and home health care services. Funding for Ontario long-term care centres is based on reimbursement for the level of care expected to be required by residents. The provincial government allocates funds, or "envelopes", for services such as nursing, programs, food and accommodation. Providers may retain excess funding over costs incurred only with respect to the accommodation envelope, while funding for the other envelopes is returned to the extent costs incurred are below the rates funded, otherwise referred to as "flow-through envelopes".

### **Ontario Long-term Care Legislation**

New legislation governing Ontario long-term care facilities, the Long-term Care Homes Act, 2007 (Bill 140) was given Royal Assent on June 4, 2007, although it will not be proclaimed into law until the regulations dealing with the specific aspects of the legislation are developed and approved. Bill 140 amalgamates three existing pieces of legislation currently governing long-term care facilities in the province: the Nursing Homes Act; the Homes for the Aged and Rest Homes Act; and the Charitable Institutions Act. Through consolidation, the government expects that Bill 140 will ensure uniform standards and accountability. Among other things, Bill 140 includes a new licensing process with defined terms for various classes of homes as follows: one year for "D" rated facilities that have not been upgraded; 10 years for upgraded "D" rated facilities; 15 years for "C" and "B" rated facilities; 20 years for "A" rated facilities; and 25 years for new homes. ECI has 11 new facilities in Ontario and the rest are "C" rated facilities. Bill 140 does not include a commitment to a capital renewal program for older buildings. However, on July 31, 2007, the government announced a redevelopment project to address this issue. The government announced that it will be redeveloping 35,000 older long-term care beds over the next 10 years, beginning in 2008 with 3,500 beds being redeveloped annually. ECI currently owns and operates approximately 3,572 older long-term care beds in 23 "C" rated facilities that would benefit from this redevelopment project. Details of the project have not as yet been provided. ECI and others continue to advocate for appropriate changes and will work to provide input to the drafting of the regulations.

### **Ontario Long-term Care Funding**

On July 30, 2007, the Ontario government announced a 26% increase in the daily food allowance for long-term care residents to \$7.00 effective September 1, 2007. Based on the number of residents served at June 30, 2007, this flow-through funding represents additional annual revenue to ECI of approximately \$2.6 million, and is required to be directed towards enhanced food costs.

Effective July 1, 2007, the government provided an increase of \$0.11 per resident per day (or 2%) in funding for food costs and an increase of \$0.74 per resident per day (or 1.6%) in the per diem rate for the non flow-through accommodation envelope. ECI estimates that based on the number of long-term care beds it operates in Ontario, these funding enhancements represent additional annual revenue of approximately \$1.5 million, of which approximately \$0.2 million is directly allocated to food costs with the remainder available to assist in offsetting inflationary cost increases of accommodation.

In February 2007 the Ontario government announced the annual acuity-based flow-through funding increase of 3.15% effective April 1, 2007 (compared to 1.98% in 2006), based on the provincial 2006 resident classification results. In addition to the April 1<sup>st</sup> annual acuity-based increases received in 2006 and 2007, the government provided additional funding targeted to providing more nurses in long-term care homes to help manage the rising cost of labour within the flow-through envelopes. ECI estimates that based on the number of long-term care beds it operates in Ontario, the April 1<sup>st</sup> flow-through funding increases received in 2006 and 2007 represent additional annual revenue of approximately \$4.4 million and \$6.0 million, respectively. These funding enhancements were provided to the flow-through envelopes and therefore, are offset by additional costs for resident care.

Effective July 1, 2006, the government provided an increase of \$0.12 per resident per day (or 2.25%) in funding for food costs and an increase of \$0.78 per resident per day (or 1.76%) in the per diem rate for the non flow-through accommodation envelope. ECI estimates that based on the number of long-term care beds it operates in Ontario, these funding enhancements represent additional annual revenue of approximately \$1.6 million, of which approximately \$0.2 million is directly allocated to food costs with the remainder available to assist in offsetting inflationary cost increases of accommodation.

### **Alberta Long-term Care Funding**

At the time of this report, three of the five health regions in which ECI operates confirmed their April 1, 2007 inflationary funding increases, which represented a weighted average increase to ECI of approximately 3.8%.

On July 25, 2007, the Alberta government announced a long-term care accommodation fee increase of approximately 5% effective October 1, 2007, to meet rising costs. The province's last adjustment to accommodation fees occurred in 2003. For ECI, based on the long-term care beds operated in Alberta as of June 30, 2007, this funding improvement is expected to represent annual revenue of approximately \$0.9 million.

In March 2006 the Alberta government announced its 2006/2007 fiscal budget in which \$42.0 million was allocated to improve continuing care services. Changes included additional funding to enable increases in the number of hours of care per resident day to 3.6 hours, required to be implemented by January 2007. As a result, ECI does not anticipate a significant impact to earnings from these changes. An annual inflationary rate increase of 3.25% was received by long-term care providers effective April 1, 2006. As well, the July 1, 2006, annual funding adjustment for the case mix index was received, which varies by facility and can result in an increase or decrease in funding depending on the change in resident acuity levels. For ECI, the net impact of the July 2006 case mix index adjustments was minimal.

### **Ontario Home Care Funding**

ECI is a major private-sector provider of home health care services through ParaMed, which operates in Alberta and Ontario. Ontario is ParaMed's largest market, representing approximately 96% of its revenue for the first half of 2007.

On May 1, 2006, the Ontario government announced funding of \$117.8 million to improve home care, of which \$30.0 million would be used to implement recommendations from a comprehensive review (the "Caplan Report") of the Community Care Access Centre Procurement Process. The announcement stated it was the intention of the government to implement 68 of 70 recommendations from the Caplan Report, which is intended to improve the procurement model with open and transparent practices, improve the quality and continuity of care, and support home care workforce stability. A Personal Support Worker Stabilization Strategy resulted in funding that was released in November 2006 on a retroactive basis to April 2006. ECI's portion for the period April 1, 2006 to March 31, 2007 was \$4.3 million. From April 1, 2007, this funding is continued to be paid to providers separately until contracts under the request for proposal (RFP) process are resumed and the funding is then able to be embedded in the contractual rates. Service providers will be required to report how the funds were spent. The majority of the funds received by ECI were allocated towards labour-related costs, such as compensation payments, enhanced travel and training programs and other employee benefits.

As well, as part of the Ontario government's strategy to reduce emergency room wait times, the government announced in October 2006, additional funding of \$30.0 million to support home care service volumes.

The home health care RFP process will resume in August 2007 under a revised template. RFPs had been frozen since 2004 as a result of the study undertaken by the Ontario government and contracts that were due to expire were extended.

### **Regulatory Environment Affecting Operations**

Extendicare operates in a competitive marketplace and depends substantially on revenue derived from government sources, with the remaining revenue derived from commercial insurers, managed care plans and private individuals. The ongoing pressures from government programs, along with other payors seeking to control costs and/or limit reimbursement rates for medical services, are a risk to Extendicare. Extendicare also operates in a heavily regulated industry, subject to the scrutiny of federal, state and provincial regulators. Each of EHSI's and ECI's nursing homes must comply with regulations regarding staffing levels, resident care standards, occupational health and safety, resident confidentiality, billing and reimbursement, along with environmental, biological and other standards. Government agencies have steadily increased their enforcement activity over the past several years. Management continually allocates increased resources to ensure compliance with and respond to, inspections, investigations and/or enforcement actions, and to improve the quality of services provided to Extendicare's residents.

In 1998 CMS created the Special Focus Facility (SFF) program for the purpose of decreasing the number of persistently poorly performing nursing homes. Under the SFF program, immediate sanctions must be imposed on a SFF nursing facility that fails to achieve and maintain significant progress in correcting deficiencies. Sanctions may include termination from the Medicare and/or Medicaid programs. SFF facilities that significantly improve may be removed from the SFF list. EHSI has certain facilities currently included in the SFF program, and like other operators, its facilities can be subject to the SFF program at any time. These facilities are being aggressively monitored by management.

On June 4, 2007, Extencicare REIT filed a Form 15F with the United States Securities and Exchange Commission (the "SEC") to voluntarily deregister its trust units under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Upon filing of the Form 15F, Extencicare REIT's obligation to file reports under sections 13(a) or 15(d) of the Exchange Act was immediately suspended. Management expects that deregistration of the REIT Units will become effective 90 days after the date of filing of the Form 15F with the SEC.

## Summary of Quarterly Results

The following is a summary of selected consolidated financial information derived from unaudited interim period consolidated financial statements for each of the eight most recently completed quarters. Certain comparative figures have been reclassified for discontinued operations identified in 2007.

<i>(thousands of dollars unless otherwise noted)</i>	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2007	2006	2007	2006	2006	2005	2006	2005
<b>Revenue</b>	<b>456,844</b>	421,455	<b>443,906</b>	425,198	434,004	416,920	452,951	421,814
<b>EBITDA</b> <sup>(1)</sup>	<b>52,634</b>	41,770	<b>54,033</b>	48,409	47,985	50,357	50,489	44,817
<b>Earnings from continuing health care operations before undernoted</b> <sup>(1)</sup>	<b>17,752</b>	10,807	<b>14,149</b>	13,725	15,932	15,301	16,283	18,266
Gain (loss) on derivative financial instruments and foreign exchange, net of taxes	<b>897</b>	70	<b>11,521</b>	215	(9,893)	89	(46,415)	221
Gain (loss) from restructuring charges, asset disposals and other items, net of taxes	–	(1,228)	<b>1,428</b>	(2,349)	(7,929)	7,165	(22,294)	1,751
Taxes associated with reorganization	–	–	–	(15,570)	–	–	–	–
Share of equity accounted earnings	<b>580</b>	850	<b>961</b>	1,603	1,239	764	1,528	875
<b>Earnings (loss) from continuing operations</b>	<b>19,229</b>	10,499	<b>28,059</b>	(2,376)	(651)	23,319	(50,898)	21,113
Discontinued operations, net of income taxes	<b>(3,863)</b>	3,219	<b>250</b>	18	2,307	5,431	2,154	1,388
<b>Net earnings (loss)</b>	<b>15,366</b>	13,718	<b>28,309</b>	(2,358)	1,656	28,750	(48,744)	22,501
<b>Components of Diluted Earnings (Loss) per Unit/Share</b> (\$) <sup>(2)</sup>								
Continuing health care operations before undernoted	<b>0.25</b>	0.15	<b>0.20</b>	0.20	0.23	0.22	0.23	0.26
Gain (loss) on derivative financial instruments and foreign exchange	<b>0.01</b>	–	<b>0.17</b>	–	(0.14)	–	(0.67)	–
Gain (loss) from restructuring charges, asset disposals and other items	–	(0.01)	<b>0.02</b>	(0.04)	(0.12)	0.10	(0.32)	0.03
Taxes assoc. with reorganization	–	–	–	(0.23)	–	–	–	–
Share of equity accounted earnings	<b>0.01</b>	0.01	<b>0.01</b>	0.03	0.02	0.01	0.02	0.01
<b>Earnings (loss) from continuing operations</b>	<b>0.27</b>	0.15	<b>0.40</b>	(0.04)	(0.01)	0.33	(0.74)	0.30
Discontinued operations	<b>(0.05)</b>	0.05	–	–	0.03	0.08	0.03	0.02
<b>Net earnings (loss)</b>	<b>0.22</b>	0.20	<b>0.40</b>	(0.04)	0.02	0.41	(0.71)	0.32

<sup>(1)</sup> Refer to discussion of non-GAAP measures.

<sup>(2)</sup> Diluted earnings per share calculations are prior to the Subordinate Voting Share preferential dividend.

## **Non-GAAP Measures**

Extencicare REIT assesses and measures operating results and financial position based on performance measures referred to as "EBITDA", "continuing health care operations before undernoted", "Distributable Income", "Funds from Operations", "Adjusted Funds from Operations" and "Adjusted Gross Book Value". 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 the REIT to make cash distributions; or (ii) certain ongoing rights and obligations of the REIT 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 operations, net earnings (loss) for the period, cash flow, or other measures of financial performance and liquidity reported in accordance with Canadian GAAP.

References to "EBITDA" in this document are to earnings from continuing operations before interest, income taxes, depreciation, amortization, and accretion. In this calculation, the REIT has excluded the line items "loss (gain) on derivative financial instruments and foreign exchange" and "loss (gain) from restructuring charges, asset disposals and other items". These line items are reported separately because they relate to the change in the fair value of, or gains and losses on termination of, interest rate lock, interest rate cap and foreign currency contracts, as well as gains or losses on the disposal or impairment of assets, provisions for restructuring charges, foreign exchange gains or losses on capital items, and the write-off of unamortized financing costs on early retirement of debt. These items are reported separately and excluded from EBITDA, because they are transitional in nature and would otherwise distort historical trends. Management believes that certain lenders, investors and analysts use EBITDA to measure a company's ability to service debt and meet other payment obligations, and as a common valuation measurement in the long-term care industry. For example, certain of EHSI's debt covenants use EBITDA in their calculations. EBITDA is presented by the REIT on a consistent basis from period to period, thereby allowing for consistent comparability of its operating performance.

In addition, significant income tax items that did not relate to income earned in the current period are reported separately and have been identified as "taxes associated with reorganization". In the second quarter of 2006, an income tax provision was recorded with respect to the Reorganization and related primarily to withholding taxes on the cumulative undistributed share of earnings of EHSI.

The above line items are calculated on an after-tax basis as a means of deriving the remaining earnings from health care operations and related diluted earnings per unit/share, the results of which are referred to as "continuing health care operations before undernoted". This is a measure commonly used by the REIT and its investors as a means of assessing the performance of the core operations in comparison to prior periods.

Distributable Income, or DI, is defined by Extencicare REIT's Deed of Trust as net earnings (loss) of the REIT, on a consolidated basis, as determined in accordance with GAAP, subject to certain adjustments as set out in the REIT's Deed of Trust. Funds from Operations, or FFO, is defined as net earnings (loss) of the REIT adjusted for non-cash items and other items not representative of the REIT's operating performance. Adjusted Funds from Operations, or AFFO, is defined as Distributable Income further reduced by maintenance (non-growth) capital expenditures not already reflected in the calculation of Distributable Income.

The following is a reconciliation of earnings (loss) from continuing health care operations before income taxes to EBITDA for each of the eight most recently completed quarters, and for the six months ended June 2007 and 2006. Certain comparative figures have been reclassified for discontinued operations identified in 2007.

<i>(millions of dollars)</i>	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2007	2006	2007	2006	2006	2005	2006	2005
<b>Earnings (loss) from continuing health care operations before income taxes</b>	<b>24.9</b>	13.4	<b>41.3</b>	17.9	(8.4)	35.4	(63.2)	23.1
Add (deduct)								
Depreciation and amortization	<b>12.7</b>	12.1	<b>12.3</b>	11.9	12.0	12.5	12.4	11.7
Accretion expense	<b>0.3</b>	0.3	<b>0.3</b>	0.3	0.3	0.3	0.3	0.3
Interest, net	<b>16.2</b>	14.2	<b>17.8</b>	14.9	14.7	13.7	13.7	12.2
Loss (gain) on derivative financial instruments and foreign exchange	<b>(1.5)</b>	(0.1)	<b>(15.6)</b>	(0.3)	16.6	(0.1)	10.3	(0.3)
Loss (gain) from restructuring charges, asset disposals and other items	–	1.9	<b>(2.2)</b>	3.8	12.8	(11.4)	77.0	(2.2)
<b>EBITDA</b>	<b>52.6</b>	41.8	<b>54.0</b> <sup>(1)</sup>	48.4 <sup>(1)</sup>	48.0	50.4	50.5	44.8

<sup>(1)</sup> Does not add due to rounding.

<i>(millions of dollars)</i>	Six months ended June	
	2007	2006
<b>Earnings (loss) from continuing health care operations before income taxes</b>	<b>66.2</b>	31.3
Add (deduct)		
Depreciation and amortization	<b>25.0</b>	24.0
Accretion expense	<b>0.7</b>	0.6
Interest, net	<b>34.0</b>	29.1
Loss (gain) on derivative financial instruments and foreign exchange	<b>(17.1)</b>	(0.5)
Loss (gain) from restructuring charges, asset disposals and other items	<b>(2.2)</b>	5.7
<b>EBITDA</b>	<b>106.7</b> <sup>(1)</sup>	90.2

<sup>(1)</sup> Does not add due to rounding.

### Impact of Foreign Currency Translation

The majority of Extencicare's operations are conducted in the United States, which accounted for 69.1% of continuing revenue in the first half of 2007. As a result changes in the exchange rates used to translate the results of the U.S. operations to Canadian dollars can affect the comparison of the consolidated results.

The table below illustrates the changes in the average exchange rates used in translating the U.S. results for the first six months of 2007 and 2006, and its effect on the results for the first half of 2007.

	2007	2006
Average US/Canadian dollar exchange rate for the six-month periods	<b>1.1349</b>	1.1382
<b>Impact on Six months ended June 2007</b> <i>(millions of dollars)</i>		
Revenue	<b>(1.8)</b>	
EBITDA	<b>(0.2)</b>	
Net earnings	<b>(0.3)</b>	

## 2007 Second Quarter Results

<i>(millions of dollars unless otherwise noted)</i>	<b>Q2 2007</b>	<b>Q2 2006</b>	<i>Change Q2/07 over Q2/06</i>	<b>Q1 2007</b>	<i>Change Q2/07 over Q1/07</i>
<b>Earnings (Loss) from Continuing Health Care Operations</b>					
U.S. operations in its functional currency (US\$)	17.3	(5.2)	22.5	13.6	3.7
Translation to Canadian dollars	1.7	(0.8)		2.3	
U.S. operations (C\$)	19.1 <sup>(1)</sup>	(6.0)	25.1	15.9	3.2
Canadian operations	8.0	2.0	6.0	2.7	5.3
	27.1	(4.0)	31.1	18.6	8.5
<b>Share of equity accounted earnings</b>	<b>1.0</b>	<b>1.6</b>	<b>(0.6)</b>	<b>0.6</b>	<b>0.4</b>
<b>Earnings (loss) from continuing operations</b>	<b>28.1</b>	<b>(2.4)</b>	<b>30.5</b>	<b>19.2</b>	<b>8.9</b>
<b>Discontinued operations</b>	<b>0.2</b>	<b>–</b>	<b>0.2</b>	<b>(3.9)</b>	<b>4.1</b>
<b>Net earnings (loss)</b>	<b>28.3</b>	<b>(2.4)</b>	<b>30.7</b>	<b>15.4<sup>(1)</sup></b>	<b>12.9<sup>(1)</sup></b>
<b>Diluted Earnings (Loss) per Unit/Subordinate Voting Share (\$)</b>					
Earnings (loss) from continuing operations	0.40	(0.03)		0.27	
Net earnings (loss)	0.40	(0.03)		0.22	
<b>Earnings (Loss) from Continuing Health Care Operations before Undernoted</b>					
U.S. operations in its functional currency (US\$)	10.6	8.5	2.1	12.8	(2.2)
U.S. operations (C\$)	11.6	9.6	2.0	15.0	(3.4)
Canadian operations	2.5	4.1	(1.6)	2.7	(0.2)
<b>Earnings (loss) from continuing health care operations before undernoted</b>	<b>14.1</b>	<b>13.7</b>	<b>0.4</b>	<b>17.8<sup>(1)</sup></b>	<b>(3.7)<sup>(1)</sup></b>
Gain on derivative financial instruments and foreign exchange	11.5	0.2	11.3	0.9	10.6
Gain (loss) from restructuring charges, asset disposals and other items	1.4	(17.9)	19.3	–	1.4
<b>Earnings (loss) from continuing health care operations</b>	<b>27.1<sup>(1)</sup></b>	<b>(4.0)</b>	<b>31.1<sup>(1)</sup></b>	<b>18.6<sup>(1)</sup></b>	<b>8.5<sup>(1)</sup></b>
Average US/Canadian dollar exchange rate	1.0986	1.1219		1.1716	

<sup>(1)</sup> Does not add due to rounding.

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were: 1.0986 for the 2007 second quarter, 1.1219 for the 2006 second quarter and 1.1716 for the 2007 first quarter. Net earnings for the 2007 second quarter were negatively impacted by \$0.1 million as a result of applying the lower 2007 average foreign exchange rate versus the 2006 rate on translation of the U.S. operations.

**Earnings from continuing health care operations** prior to separately reported items, as noted in the table above, improved slightly to \$14.1 million (\$0.20 per diluted unit) in the 2007 second quarter from \$13.7 million (\$0.20 per diluted share) in the 2006 second quarter. Separately reported items in the 2007 second quarter related to the valuation of derivative financial instruments and foreign exchange gains on capital items of \$11.5 million after-tax (\$0.17 per diluted unit) and an after-tax gain of \$1.4 million (\$0.02 per diluted unit) on the disposal of non-core assets. Such items in the 2006 second quarter were an after-tax gain of \$0.2 million on the valuation of derivative financial instruments and an after-tax loss of \$17.9 million (\$0.27 loss per diluted share) related primarily to the Reorganization. The REIT's share of equity earnings from Crown Life was \$1.0 million in the 2007 second quarter compared to \$1.6 million in the 2006 second quarter. Earnings from continuing operations, after one-time restructuring charges and other items, were \$28.1 million (\$0.40 per diluted unit) compared to a loss of \$2.4 million (\$0.03 loss per diluted Subordinate Voting Share) in the 2006 second quarter.

**Earnings from continuing U.S. operations** were \$19.1 million compared to a loss of \$6.0 million in the 2006 second quarter. Excluding separately reported after-tax gains of \$7.5 million in the 2007 second quarter, and a loss of \$15.6 million in the 2006 second quarter, earnings from U.S. operations were \$11.6 million and \$9.6 million, respectively. The improvement of \$2.0 million resulted primarily as a result of nursing home funding increases and newly acquired facilities. Total financing costs of the U.S. operations were relatively unchanged. However, external financing costs increased \$2.6 million due to higher debt levels resulting from the Reorganization, acquisitions and growth capital expenditures, which was partially offset by a \$2.4 million increase in interest income from intercompany loans to the Canadian operations.

**Earnings from continuing Canadian operations** were \$8.0 million in the 2007 second quarter compared to \$2.0 million in the 2006 second quarter. Excluding a separately reported after-tax foreign exchange gain of \$5.5 million in the 2007 second quarter, and an after-tax loss from restructuring charges and other items of \$2.1 million in the 2006 second quarter, earnings from Canadian operations were \$2.5 million and \$4.1 million, respectively. The lower earnings of \$1.6 million were primarily due to higher financing costs associated with the 2006 Reorganization and items affecting the tax provision. The core nursing home operations improved between periods due to funding improvements partially offset by higher operating costs. Net interest costs increased by \$2.7 million, of which \$2.4 million related to intercompany borrowings from the U.S. operations. As well, the tax provision between periods was unfavourably impacted by approximately \$1.9 million associated with the following two items: the enactment of the SIFT Proposals in June 2007, resulted in additional tax of approximately \$1.1 million booked in the 2007 second quarter related to the 2007 first quarter; and a future income tax recovery of approximately \$0.8 million was recorded in the 2006 second quarter resulting from the enactment of lower future income tax rates.

**Discontinued operations** reported earnings of \$0.2 million in the 2007 second quarter and were essentially breakeven in the 2006 second quarter. The 2006 second quarter included the earnings of ALC that were distributed to shareholders in November 2006. Further details of the components of the results of the discontinued operations are provided in *note 5* of the unaudited consolidated financial statements for the six months ended June 30, 2007.

**Earnings from continuing health care operations in comparison to the 2007 first quarter** improved by \$8.5 million to \$27.1 million from \$18.6 million. The 2007 second quarter results included an after-tax gain of \$11.5 million from derivative financial instruments and a foreign exchange gain, and an after-tax gain of \$1.4 million on the disposal of non-core assets. The 2007 first quarter results included an after-tax gain of \$0.9 million from derivative financial instruments. Prior to these items, earnings from continuing health care operations were \$14.1 million in the 2007 second quarter compared to earnings of \$17.8 million in the 2007 first quarter, representing a decline of \$3.7 million primarily due to a higher tax provision resulting from SIFT tax of \$2.3 million in the 2007 second quarter, and a non-recurring favourable book-to-file tax adjustment of \$1.4 million in the 2007 first quarter. Improvements in operations were offset by higher financing costs and a stronger Canadian dollar.

## Revenue

**Revenue from continuing operations** improved by \$18.7 million to \$443.9 million in the 2007 second quarter from \$425.2 million in the 2006 second quarter. Newly acquired facilities generated revenue of \$13.8 million in the 2007 second quarter and \$8.2 million in the 2006 second quarter, for a favourable improvement of \$5.6 million. Revenue from same-facility operations increased \$19.3 million, or 4.6%, prior to a \$6.2 million unfavourable impact of a stronger Canadian dollar, due to funding improvements and higher Medicare census and patient acuity mix, partially offset by lower Medicaid occupancy.

<i>(millions of dollars unless otherwise noted)</i>	<b>Q2 2007</b>	<b>Q2 2006</b>	<i>Change Q2/07 over Q2/06</i>	<i>Change (%)</i>	<b>Q1 2007</b>	<i>Change Q2/07 over Q1/07</i>
<b>Revenue</b>						
U.S. operations in its functional currency (US\$)	<b>275.4</b>	257.3	18.1	7.0	272.9	2.5
Translation to Canadian dollars	<b>27.1</b>	31.4			46.8	
U.S. operations (C\$)	<b>302.5</b>	288.7	13.8	4.8	319.7	(17.2)
Canadian operations	<b>141.4</b>	136.5	4.9	3.6	137.1	4.3
	<b>443.9</b>	425.2	18.7	4.4	456.8	(12.9) <sup>(1)</sup>

**Revenue from U.S. operations** grew 7.0% in its functional currency to US\$275.4 million in the 2007 second quarter compared to US\$257.3 million in the 2006 second quarter, representing an increase of US\$18.1 million, of which US\$5.3 million was from acquired facilities. Acquisitions were comprised of a Wisconsin nursing home in May 2007, two Kentucky nursing homes in August 2006 and two Pennsylvania nursing homes in March 2006. Revenue on a same-facility basis increased by US\$12.8 million or 5.1%.

The following table provides further details on the change in revenue from same-facility U.S. operations.

(US\$ millions)

12.4	– increase in average nursing home rates (Medicare \$4.3 million, Medicaid \$4.7 million, and private/other \$3.4 million)
(0.7)	– increase (decrease) in nursing home resident census (Medicare \$1.8, Medicaid \$(1.6) million, and private/other \$(0.9) million)
0.2	– increase in nursing home resident ancillary services, primarily therapy and rehabilitative services
1.3	– other revenue
13.2	
(0.4)	– lower prior period revenue adjustments (none in 2007 compared to \$0.4 million in 2006 second quarter)
12.8	

Key Medicare and Medicaid statistics for the U.S. nursing home operations are summarized in the following table.

<b>U.S. Nursing Home Operating Statistics</b>	<b>Q2 2007</b>	<b>Q2 2006</b>	<i>Change Q2/07 over Q2/06 (%)</i>	<b>Q1 2007</b>	<i>Change Q2/07 over Q1/07 (%)</i>
Average daily census (same-facility basis)					
Medicare	<b>2,347</b>	2,293	2.4	2,379	(1.3)
Private/other	<b>1,936</b>	1,987	(2.6)	1,948	(0.6)
Medicaid	<b>8,170</b>	8,285	(1.4)	8,188	(0.2)
Total	<b>12,453</b>	12,565	(0.9)	12,515	(0.5)
Medicare as a percent of total census (same-facility basis)	<b>18.9</b>	18.3		19.0	
Medicaid as a percent of total census (same-facility basis)	<b>65.6</b>	65.9		65.4	
Average percentage occupancy (same-facility basis)	<b>90.3</b>	91.6		90.8	
Average revenue rate by payor source (US\$) <sup>(1)</sup>					
Medicare Part A and B	<b>423.62</b>	404.19	4.8	424.04	(0.1)
Private/other	<b>239.18</b>	218.88	9.3	239.31	(0.1)
Medicaid	<b>158.38</b>	151.87	4.3	157.68	0.4
Medicare Part A	<b>388.93</b>	369.48	5.3	387.95	0.3

<sup>(1)</sup> Excludes prior period settlement adjustments.

EHSI's average daily Medicare Part A rate increased 5.3% to US\$388.93 in the 2007 second quarter from US\$369.48 in the 2006 second quarter. CMS's annual inflationary rate increase was 3.1% effective October 1, 2006 and the balance of the improvement was attributable to the increase in the acuity care levels of Medicare patients served. For further details, refer to "Significant Developments – Medicare Funding".

Excluding the impact of the prior period Medicaid settlement adjustments, EHSI's average Medicaid rate increased 4.3% from the 2006 second quarter. For a number of states, the increase in average Medicaid revenue per resident day was primarily attributable to increases in acuity of care levels and funding for increased state assessment fees and taxes.

**Revenue from Canadian operations** grew \$4.9 million, or 3.6%, in the 2007 second quarter over the 2006 second quarter. Of this improvement, \$4.9 million was derived from nursing home operations, and represented funding to enhance resident care. Home health care revenue declined by \$0.5 million due primarily to a reduction in volumes in Alberta. Other revenue from Canadian operations increased by \$0.5 million.

## EBITDA

**Operating, administrative and lease costs from continuing operations** increased \$13.1 million to \$389.9 million in the 2007 second quarter from \$376.8 million in the 2006 second quarter. Newly acquired facilities contributed \$4.2 million to the increase, and a stronger Canadian dollar favourably impacted these costs by \$5.3 million. Operating, administrative and lease costs from same-facility operations, excluding the impact of the stronger Canadian dollar, increased \$14.2 million, of which labour related costs accounted for \$10.0 million of the increase.

Labour-related costs from continuing operations represented 74.1% of operating and administrative costs in the 2007 second quarter compared to 74.4% in the 2006 second quarter, and as a percent of revenue, were 64.6% and 65.3%, respectively.

**EBITDA from same-facility operations** was \$52.0 million in the 2007 second quarter compared to \$47.8 million in the 2006 second quarter, representing an improvement of \$4.2 million. As a percent of revenue, EBITDA from same-facility operations improved to 12.1% from 11.5% in the 2006 second quarter due to funding improvements, higher Medicare ADC and changes in Medicare patient mix.

<i>(millions of dollars unless otherwise noted)</i>	<b>Q2</b>	<i>% of</i>	<b>Q2</b>	<i>% of</i>	<i>Change</i>	<i>Change</i>	<b>Q1</b>	<i>Change</i>
	<b>2007</b>	<i>revenue</i>	<b>2006</b>	<i>revenue</i>	<i>Q2/07</i>	<i>Q2/06</i>	<b>2007</b>	<i>Q2/07</i>
					<i>over</i>	<i>(%)</i>		<i>over</i>
					<i>Q2/06</i>			<i>Q1/07</i>
<b>EBITDA</b>								
U.S. operations in its functional currency (US\$)	<b>36.1</b>	<i>13.1</i>	32.1	<i>12.5</i>	4.0	<i>12.5</i>	35.7	0.4
Translation to Canadian dollars	<b>3.5</b>		4.0				6.1	
U.S. operations (C\$)	<b>39.6</b>	<i>13.1</i>	36.1	<i>12.5</i>	3.5	<i>9.7</i>	41.8	(2.2)
Canadian operations	<b>14.4</b>	<i>10.2</i>	12.3	<i>9.0</i>	2.1	<i>17.1</i>	10.9	3.5
	<b>54.0</b>	<i>12.2</i>	48.4	<i>11.4</i>	5.6	<i>11.6</i>	52.6 <sup>(1)</sup>	1.4 <sup>(1)</sup>
Average US/Canadian dollar exchange rate	<b>1.0986</b>		1.1219				1.1716	

<sup>(1)</sup> Does not add due to rounding.

**EBITDA from U.S. operations** improved US\$4.0 million to US\$36.1 million in the 2007 second quarter from US\$32.1 million in the 2006 second quarter, and as a percent of revenue was 13.1% compared to 12.5% in the 2006 second quarter. Excluding an improvement between periods of US\$1.3 million attributable to newly acquired facilities, EBITDA from same-facility operations was US\$34.3 million in the 2007 second quarter compared to US\$31.6 million in the 2006 second quarter, representing an increase of US\$2.7 million. Improvements in revenue from same-facility operations of US\$12.8 million discussed above were partially offset by higher operating, administrative and lease costs of US\$10.1 million, as detailed in the table below.

*(US\$ millions)*

7.5	– rise in labour-related costs of 4.9%, which included an average wage rate increase of 5.0% in nursing home operations
1.0	– increase in provision for bad debts
0.7	– increase in utilities, telephone and travel costs
0.6	– increase in drug costs
0.6	– increase in repairs and maintenance
0.4	– increase in food and supplies
(1.2)	– decrease in professional fees, fines and penalties
0.5	– increase in other costs
<b>10.1</b>	

Labour-related cost increases were primarily driven by enhancements offered to attract and/or retain therapists, as part of management's strategy to focus on Medicare rehabilitative residents. Labour costs for the U.S. operations in each of the second quarters of 2007 and 2006 represented 70.2% and 70.4% of operating and administrative costs, and represented 60.6% and 61.0% of revenue, respectively.

**EBITDA from Canadian operations** was \$14.4 million in the 2007 second quarter compared to \$12.3 million in the 2006 second quarter, representing an improvement of \$2.1 million. Revenue improvements of \$4.9 million and lower administrative costs of \$0.8 million were partially offset by higher operating and lease costs of \$3.6 million.

**Consolidated EBITDA** improved by \$1.4 million to \$54.0 million in the 2007 second quarter from \$52.6 million in the 2007 first quarter, of which the stronger Canadian dollar unfavourably impacted EBITDA by \$2.6 million. EBITDA from Canadian operations improved by \$3.5 million, which was a normal seasonal trend due to lower utility costs of \$1.8 million and April 1<sup>st</sup> funding changes. EBITDA from U.S. operations improved by US\$0.4 million in its functional currency due to an increase in Medicaid rates, lower utility costs and an extra day in the quarter, partially offset by lower average daily census and an increase in provision for bad debts and repairs and maintenance costs.

### **Depreciation, Amortization and Accretion**

Depreciation, amortization and accretion costs were higher by \$0.5 million in the 2007 second quarter from the 2006 second quarter primarily due to acquisitions and construction.

### **Interest**

Interest expense, net of interest income, increased \$2.9 million in the 2007 second quarter from the 2006 second quarter primarily due to the increase in long-term debt associated with the Reorganization and acquisitions.

### **Income Taxes**

The tax provision from continuing operations was \$14.2 million in the 2007 second quarter compared to \$21.8 million in the 2006 second quarter. The effective tax rate for the 2007 second quarter was 34.4% compared to 122.3% in the 2006 second quarter, both of which were distorted by gains and losses from derivative financial instruments, foreign exchange, restructuring charges, asset disposals and other items. Excluding these items, the effective tax rate for the 2007 second quarter was 40.0% compared to 35.6% in the 2006 second quarter. The current tax provision for the 2007 second quarter included a provision for the 2007 first quarter SIFT tax of approximately \$1.1 million and the 2006 second quarter tax provision included a future income tax recovery of \$0.8 million due to a reduction in future income tax rates. Excluding these items the effective tax rate for the 2007 second quarter would have been 35.2% compared to 39.6% in the 2006 second quarter.

Since Bill C-52 was substantially enacted in June 2007, the REIT has recorded a provision in the 2007 second quarter for SIFT tax of \$2.3 million for the six months ended June. The provision represents management's estimate of the SIFT tax based on Extencicare REIT's current structure, operations and current level of return of capital, its understanding of the SIFT Proposals and certain assumptions. For further information on this, refer to the discussion under "Significant Developments – Proposed Canadian Federal Income Tax on Income Trusts".

### **Share of Equity Accounted Earnings**

The reported share of equity accounted earnings was \$1.0 million in the 2007 second quarter compared to \$1.6 million in the 2006 second quarter. The 2007 second quarter amount of \$1.0 million was comprised of Extencicare's share of Crown Life's earnings of \$6.6 million offset by \$5.6 million to reflect the expected value of the proceeds on closing of the sale of Crown Life. In order for Crown Life to make a cash dividend payment to its shareholders on June 29, 2007, prior to the final closing on July 5, 2007, Crown Life liquidated a number of its investments, which resulted in a realization of gains that had been accumulated in other comprehensive income. However, the realization of these gains had already been considered by Extencicare when estimating the final settlement amounts in prior periods. For further information, refer to "Significant Developments – Investment in Crown Life Insurance Company".

## 2007 Six Months Results

<i>(millions of dollars unless otherwise noted)</i>	Six months ended June		
	2007	2006	Change
<b>Earnings (Loss) from Continuing Health Care Operations</b>			
U.S. operations in its functional currency (US\$)	30.9	3.4	27.5
Translation to Canadian dollars	4.1	0.5	
U.S. operations (C\$)	35.0	3.9	31.1
Canadian operations	10.8	1.8	9.0
	45.7 <sup>(1)</sup>	5.7	40.0 <sup>(1)</sup>
<b>Share of equity accounted earnings</b>	1.5	2.5	(1.0)
<b>Earnings (loss) from continuing operations</b>	47.3 <sup>(1)</sup>	8.1 <sup>(1)</sup>	39.2 <sup>(1)</sup>
<b>Discontinued operations</b>	(3.6)	3.2	(6.8)
<b>Net earnings (loss)</b>	43.7	11.4 <sup>(1)</sup>	32.3 <sup>(1)</sup>
<b>Diluted Earnings (Loss) per Unit/Subordinate Voting Share (\$)</b>			
Earnings (loss) from continuing operations	0.67	0.12	
Net earnings (loss)	0.62	0.17	
<b>Earnings (Loss) from Continuing Health Care Operations before Undernoted</b>			
U.S. operations in its functional currency (US\$)	23.4	16.9	6.5
U.S. operations (C\$)	26.6	19.3	7.3
Canadian operations	5.3	5.3	–
<b>Earnings (loss) from continuing health care operations before undernoted</b>	31.9	24.5 <sup>(1)</sup>	7.4 <sup>(1)</sup>
Gain (loss) on derivative financial instruments and foreign exchange	12.4	0.3	12.1
Gain (loss) from restructuring charges, asset disposals and other items	1.4	(19.1)	20.5
<b>Earnings (loss) from continuing health care operations</b>	45.7	5.7	40.0
Average US/Canadian dollar exchange rate	1.1349	1.1382	

<sup>(1)</sup> Does not add due to rounding.

The average exchange rates used to translate the results of the U.S. operations to Canadian dollars were: 1.1349 for the first half of 2007 and 1.1382 for the first half of 2006. Net earnings for the first half of 2007 were negatively impacted by \$0.3 million as a result of applying the lower 2007 average foreign exchange rate versus the 2006 rate on translation of the U.S. operations.

**Earnings from continuing health care operations** prior to separately reported items, as indicated in the table above, were \$31.9 million (\$0.45 per diluted unit) in the first half of 2007 compared to \$24.5 million (\$0.35 per diluted share) in the first half of 2006, representing an improvement of \$7.4 million. Separately reported items in the first half of 2007 related to the valuation of derivative financial instruments and foreign exchange gains on capital items of \$12.4 million after-tax (\$0.18 per diluted unit) and an after-tax gain of \$1.4 million (\$0.02 per diluted unit) on the disposal of non-core assets. Such items in the first half of 2006 were an after-tax gain of \$0.3 million on the valuation of derivative financial instruments and an after-tax loss of \$19.1 million (\$0.28 loss per diluted share) related primarily to the Reorganization. The REIT's share of equity earnings from Crown Life was \$1.5 million in the first half of 2007 compared to \$2.5 million in the first half of 2006. Earnings from continuing operations, after one-time restructuring charges and other items, were \$47.3 million (\$0.67 per diluted unit) compared to \$8.1 million (\$0.12 per diluted Subordinate Voting Share) in the first half of 2006.

**Earnings from continuing U.S. operations** were \$35.0 million compared to \$3.9 million in the first half of 2006. Excluding separately reported after-tax gains of \$8.4 million in the first half of 2007 and a loss of \$15.4 million in the first half of 2006, earnings from U.S. operations were \$26.6 million and \$19.3 million, respectively. The improvement of \$7.3 million resulted primarily from nursing home funding increases and newly acquired facilities. Total financing costs of the U.S. operations were relatively unchanged. However, external financing costs increased \$4.8 million due to higher debt levels resulting from the Reorganization, acquisitions and growth capital expenditures, which was partially offset by a \$5.0 million increase in interest income from intercompany loans to the Canadian operations.

**Earnings from continuing Canadian operations** were \$10.8 million in the first half of 2007 compared to \$1.8 million in the first half of 2006. The 2007 results included a separately reported after-tax foreign exchange gain of \$5.5 million compared to a loss of \$3.5 million for restructuring and other items in the first half of 2006. Excluding these items, earnings from Canadian operations were \$5.3 million in both periods. The core nursing home operations improved between periods due to funding improvements partially offset by higher operating costs. General and administrative costs in the first half of 2007 were \$4.2 million lower than the first half of 2006 as a result of lower salaries and benefits primarily due to the Reorganization, of which share-based compensation costs accounted for \$2.2 million. Net interest costs were higher by \$5.1 million, of which \$5.0 million related to intercompany borrowings from the U.S. operations.

**Discontinued operations** reported a loss of \$3.6 million in the first half of 2007 compared to earnings of \$3.2 million in the first half of 2006. The 2006 results included the earnings of ALC that were distributed to shareholders in November 2006. Discontinued operations for the first half of 2007 included a pre-tax impairment charge of \$6.0 million related to an Ohio nursing home that EHSI voluntarily closed due to poor performance. Further details of the components of the results of the discontinued operations are provided in *note 5* of the unaudited consolidated financial statements for the six months ended June 30, 2007.

## Revenue

**Revenue from continuing operations** improved by \$54.1 million to \$900.8 million in the first half of 2007 from \$846.7 million in the first half of 2006. Newly acquired facilities generated revenue of \$27.1 million in the first half of 2007 and \$11.0 million in the first half of 2006, for a favourable improvement of \$16.1 million. Revenue from same-facility operations increased \$38.0 million. A stronger Canadian dollar unfavourably impacted same-facility revenue by \$1.7 million and lower U.S. prior period settlement adjustments negatively impacted revenue by \$1.8 million. Excluding these items, revenue improved between periods by \$41.5 million, or 5.0% due to funding improvements and higher Medicare census and patient acuity mix, partially offset by lower Medicaid occupancy.

<i>(millions of dollars unless otherwise noted)</i>	<b>Six months ended June</b>			
	<b>2007</b>	<b>2006</b>	<i>Change</i>	<i>Change (%)</i>
<b>Revenue</b>				
U.S. operations in its functional currency (US\$)	<b>548.3</b>	509.2	39.1	7.7
Translation to Canadian dollars	<b>74.0</b>	70.4		
U.S. operations (C\$)	<b>622.2</b> <sup>(1)</sup>	579.6	42.6	7.3
Canadian operations	<b>278.5</b>	267.1	11.4	4.3
	<b>900.8</b> <sup>(1)</sup>	846.7	54.1 <sup>(1)</sup>	6.4

<sup>(1)</sup> Does not add due to rounding.

**Revenue from U.S. operations** grew 7.7% in its functional currency to US\$548.3 million in the first half of 2007 compared to US\$509.2 million in the first half of 2006, representing an increase of US\$39.1 million, of which US\$14.2 million was from acquired facilities. Acquisitions were comprised of a Wisconsin nursing home in May 2007, two Kentucky nursing homes in August 2006 and two Pennsylvania nursing homes in March 2006. Revenue on a same-facility basis increased by US\$24.9 million and was impacted by lower prior period settlement adjustments of US\$1.6 million. Prior to the prior period settlement adjustments, revenue from same-facility operations increased by US\$26.5 million or 5.3%.

The following table provides further details on the change in revenue from same-facility U.S. operations.

<i>(US\$ millions)</i>	
25.3	– increase in average nursing home rates (Medicare \$9.0 million, Medicaid \$9.4 million, and private/other \$6.9 million)
(3.1)	– increase (decrease) in nursing home resident census (Medicare \$1.8 million, Medicaid \$(3.9) million, and private/other \$(1.0) million)
1.8	– increase in nursing home resident ancillary services, primarily therapy and rehabilitative services
2.5	– other revenue
26.5	
(1.6)	– lower prior period revenue adjustments (\$0.2 million in 2007 compared to \$1.8 million in the first half of 2006)
24.9	

Key Medicare and Medicaid statistics for the U.S. nursing home operations are summarized in the following table.

<b>U.S. Nursing Home Operating Statistics</b>	<b>Six months ended June</b>		
	<b>2007</b>	<b>2006</b>	<i>Change (%)</i>
Average daily census (same-facility basis)			
Medicare	<b>2,363</b>	2,336	1.2
Private/other	<b>1,942</b>	1,970	(1.4)
Medicaid	<b>8,179</b>	8,323	(1.7)
Total	<b>12,484</b>	12,629	(1.1)
Medicare as a percent of total census (same-facility basis)	<b>18.9</b>	18.5	
Medicaid as a percent of total census (same-facility basis)	<b>65.5</b>	65.9	
Average percentage occupancy (same-facility basis)	<b>90.5</b>	92.1	
Average revenue rate by payor source (US\$) <sup>(1)</sup>			
Medicare Part A and B	<b>423.83</b>	401.38	5.6
Private/other	<b>239.24</b>	218.17	9.7
Medicaid	<b>158.03</b>	150.94	4.7
Medicare Part A	<b>388.44</b>	368.56	5.4

<sup>(1)</sup> Excludes prior period settlement adjustments.

EHSI's average daily Medicare Part A rate increased 5.4% to US\$388.44 in the first half of 2007 from US\$368.56 in the first half of 2006. CMS's annual inflationary rate increase was 3.1% effective October 1, 2006 and the balance of the improvement was attributable to the increase in the acuity care levels of Medicare patients served. For further details, refer to "Significant Developments – Medicare Funding".

Excluding the impact of the prior period Medicaid settlement adjustments, EHSI's average Medicaid rate increased 4.7% from the first half of 2006. Of this increase, 0.4% was the result of acquisitions of nursing facilities that had higher Medicaid rates than EHSI's average Medicaid rate. For a number of states, the increase in average Medicaid revenue per resident day was primarily attributable to increases in acuity of care levels and funding for increased state assessment fees and taxes. Without these items, the average Medicaid revenue per resident day increased approximately 3.7%.

**Revenue from Canadian operations** grew \$11.4 million, or 4.3%, in the first half of 2007 over the first half of 2006. Of this improvement, \$9.3 million was derived from nursing home operations, and represented funding to enhance resident care. Revenue from home health care operations increased by \$1.4 million, or 2.0%, due primarily to funding enhancements, partially offset by lower volumes. Other revenue from Canadian operations increased by \$0.7 million.

## EBITDA

**Operating, administrative and lease costs from continuing operations** increased \$37.6 million to \$794.1 million in the first half of 2007 from \$756.5 million in the first half of 2006. Newly acquired facilities contributed \$12.8 million to the increase, and a stronger Canadian dollar favourably impacted these costs by \$1.5 million. Operating, administrative and lease costs from same-facility operations, excluding the impact of a stronger Canadian dollar, increased \$26.3 million, of which labour related costs accounted for \$18.9 million of the increase.

Labour-related costs from continuing operations represented 74.0% of operating and administrative costs in the first half of 2007 compared to 74.3% in the first half of 2006, and as a percent of revenue, were 64.7% and 65.7%, respectively. Total general and administrative costs were \$33.0 million in the first half of 2007 compared to \$36.4 million in the first half of 2006, reflecting a decline of \$3.4 million, of which \$3.1 million was due to share-based compensation costs recorded in the first half of 2006 related to the former stock option plan.

**EBITDA from same-facility operations** was \$102.4 million in the first half of 2007 compared to \$89.2 million in the first half of 2006, representing an improvement of \$13.2 million, based on the improvements in revenue of \$38.0 million partially offset by higher operating, administrative and lease costs of \$24.8 million. As a percent of revenue, EBITDA from same-facility operations improved to 11.7% from 10.7% in the first half of 2006 due to funding improvements, higher Medicare census, changes in Medicare patient mix, and lower share-based compensation costs.

<b>Six months ended June</b>						
<i>(millions of dollars unless otherwise noted)</i>	<b>2007</b>	<i>% of revenue</i>	<b>2006</b>	<i>% of revenue</i>	<i>Change</i>	<i>Change (%)</i>
<b>EBITDA</b>						
U.S. operations in its functional currency (US\$)	<b>71.7</b>	<i>13.1</i>	61.6	<i>12.1</i>	10.1	<i>16.4</i>
Translation to Canadian dollars	<b>9.7</b>		8.5			
U.S. operations (C\$)	<b>81.4</b>	<i>13.1</i>	70.1	<i>12.1</i>	11.3	<i>16.1</i>
Canadian operations	<b>25.2</b>	<i>9.1</i>	20.1	<i>7.5</i>	5.1	<i>25.4</i>
	<b>106.7<sup>(1)</sup></b>	<i>11.8</i>	90.2	<i>10.7</i>	16.5 <sup>(1)</sup>	<i>18.3</i>
Average US/Canadian dollar exchange rate	<b>1.1349</b>		1.1382			

<sup>(1)</sup> Does not add due to rounding.

**EBITDA from U.S. operations** improved US\$10.1 million to US\$71.7 million in the first half of 2007 from US\$61.6 million in the first half of 2006, and as a percent of revenue improved to 13.1% from 12.1% in the first half of 2006. Excluding an improvement between periods of US\$2.8 million attributable to newly acquired facilities, EBITDA from same-facility operations was US\$68.0 million in the first half of 2007 compared to US\$60.7 million in the first half of 2006, representing an increase of US\$7.3 million, despite lower prior period settlement adjustments of US\$1.6 million. Improvements in revenue from same-facility operations of US\$24.9 million discussed previously were partially offset by higher operating, administrative and lease costs of US\$17.6 million, as detailed in the table below.

*(US\$ millions)*

13.7	– rise in labour-related costs of 4.5%, which included an average wage rate increase of 5.0% in nursing home operations
1.7	– increase in provision for bad debts
1.4	– increase in drug costs
1.2	– increase in food and supplies
1.1	– increase in utilities, telephone and travel costs
(2.3)	– decrease in professional fees, fines and penalties
0.8	– increase in other costs
<b>17.6</b>	

Labour-related cost increases were primarily driven by enhancements offered to attract and/or retain therapists, as part of management's strategy to focus on Medicare rehabilitative residents. As a percent of operating and administrative costs, labour costs for the U.S. operations represented 70.3% in the first half of 2007 compared to 70.2% in the first half of 2006. As a percent of revenue, labour costs for the U.S. operations represented 60.6% in the first half of 2007 and 61.1% in the first half of 2006.

**EBITDA from Canadian operations** was \$25.2 million in the first half of 2007 compared to \$20.1 million in the first half of 2006, representing an improvement of \$5.1 million. The revenue improvement of \$11.4 million was partially offset by higher operating, administrative and lease costs of \$6.3 million, of which labour related costs increased by \$3.4 million.

### **Depreciation, Amortization and Accretion**

Depreciation, amortization and accretion costs were higher by \$1.1 million in the first half of 2007 from the first half of 2006 primarily due to acquisitions and construction.

### **Interest**

Interest expense, net of interest income, increased \$4.9 million in the first half of 2007 from the first half of 2006 primarily due to the increase in long-term debt associated with the Reorganization and acquisitions.

## Income Taxes

The tax provision from continuing operations was \$20.5 million in the first half of 2007 compared to \$25.6 million in the first half of 2006. The effective tax rate for the first half of 2007 was 30.9% compared to 81.9% in the first half of 2006, both of which were distorted by the gains and losses from derivative financial instruments, foreign exchange, restructuring charges, asset disposals and other items, as well as withholding taxes associated with the Reorganization. Excluding these items, the effective tax rate for the first half of 2007 was 32.1% compared to 32.8% in the first half of 2006. The 2007 tax provision included a credit of \$1.4 million recorded in the first quarter for a book-to-file adjustment related to withholding tax recorded in 2006. The comparative 2006 tax provision included a credit recorded in the first quarter of \$1.0 million related to the expiration of certain statutes of limitations of EHSI's tax liabilities, and a credit of \$0.8 million in the second quarter related to a reduction in Canadian future income tax rates. Excluding these items, the effective tax rate for the first half of 2007 would have been 35.2% compared to 38.0% in the first half of 2006.

Since Bill C-52 was substantially enacted in June 2007, the REIT has recorded a provision for the SIFT tax of \$2.3 million for the six months ended June. The provision represents management's estimate of the SIFT tax based on Extencicare REIT's current structure, operations and current level of return of capital, its understanding of the SIFT Proposals and certain assumptions. For further information on this, refer to the discussion under "Significant Developments – Proposed Canadian Federal Income Tax on Income Trusts".

## Share of Equity Accounted Earnings

The share of equity accounted earnings was \$1.5 million in the first half of 2007 compared to \$2.5 million in the first half of 2006. On July 5, 2007, Extencicare finalized the sale of its investment in Crown Life. For further information, refer to "Significant Developments – Investment in Crown Life Insurance Company".

## Liquidity and Capital Resources

### Sources and Uses of Cash

At June 30, 2007, the REIT had cash and cash equivalents of \$151.9 million compared with \$28.1 million at December 31, 2006.

<i>(thousands of dollars unless otherwise noted)</i>	Three months ended June		Six months ended June		Year
	2007	2006	2007	2006	2006
Cash provided by operations, before working capital changes	24,234	32,449	53,369	61,452	140,668
Net change in operating assets and liabilities	(900)	(10,809)	312	(6,139)	(11,884)
Cash provided by operations	23,334	21,640	53,681	55,313	128,784
Cash provided by (used in) investment activities	17,083	(12,276)	(5,379)	(49,936)	(114,094)
Cash provided by (used in) financing activities	73,459	(17,863)	80,385	5,128	(9,434)
Increase (decrease) in cash and cash equivalents	109,041	(8,894)	123,842	10,311	5,448
Cash and cash equivalents at period end	151,899	32,920	151,899	32,920	28,057
Average US/Canadian dollar exchange rate	1.0986	1.1219	1.1349	1.1382	1.1341

**Cash flow provided by operations** was \$53.7 million in the first half of 2007 compared to \$55.3 million in the first half of 2006. Cash provided by operations includes the activity of the discontinued operations, which in 2006 included ALC. Cash used in reducing accounts payable in the first half of 2007 was primarily due to a payment in January 2007 of an amount owing on prior year Medicare settlements of approximately \$14.0 million. Cash provided by the change in income taxes payable in the first half of 2007 was primarily due to a recovery of instalments relating to operations. The income taxes paid in March 2007 associated with the gain on distribution of ALC was reported as financing activity on the cash flow statement.

**Cash used in investing activities** was \$5.4 million in the first half of 2007 compared to \$49.9 million in the first half of 2006, and was lower in 2007 due to a return on the investment in Crown Life. On June 29, 2007, Extencicare received net proceeds of \$41.6 million in connection with the sale of Crown Life. Acquisition costs of \$11.5 million in the first half of 2007 related to the purchase of a previously leased Ohio nursing facility in January 2007 for \$8.7 million, and the acquisition of a 191-bed nursing home in Wisconsin for \$2.8 million in May 2007. Acquisition costs of \$28.1 million in the first half of 2006 related to the purchase of two Pennsylvania nursing homes in the 2006 first quarter.

Property and equipment expenditures, excluding acquisitions, were \$35.1 million in the first half of 2007 compared to \$32.3 million in the first half of 2006. The expenditures in 2006 included those of ALC. The table below breaks out the components of the property and equipment expenditures. Growth expenditures of the REIT relate to the construction of new beds, building improvements or capital costs aimed at earnings growth. The sprinkler project was completed during 2006 and related to the voluntary installation of sprinkler systems in the older homes. The remaining costs are the capital costs to sustain and upgrade existing property and equipment assets. These costs were \$13.8 million in the first half of 2007 compared to \$16.1 million in the first half of 2006. These expenditures fluctuate on a quarterly basis with timing of projects and seasonality. Management estimates that based on the beds currently operated, facility maintenance costs will be approximately \$34.0 million for the year 2007 compared to \$32.2 million in 2006. As a percent of revenue from continuing operations, the facility maintenance costs were between 1.8% and 2.1% over the past three years.

<b>Property and Equipment Expenditures</b> <i>(thousands of dollars unless otherwise noted)</i>	<b>Three months ended June</b>		<b>Six months ended June</b>		<b>Year</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2006</b>
<b>REIT Operations</b>					
Growth expenditures	<b>11,988</b>	6,386	<b>21,311</b>	10,287	28,398
Sprinkler project	–	330	–	797	1,125
Facility maintenance	<b>7,758</b>	9,227	<b>13,778</b>	16,068	32,249
	<b>19,746</b>	15,943	<b>35,089</b>	27,152	61,772
<b>ALC operations distributed</b>	–	2,548	–	5,162	14,829
<b>Consolidated reported</b>	<b>19,746</b>	18,491	<b>35,089</b>	32,314	76,601
Average US/Canadian dollar exchange rate	<b>1.0986</b>	1.1219	<b>1.1349</b>	1.1382	1.1341

Net proceeds from dispositions of \$2.2 million in the first half of 2007 and \$1.9 million in the first half of 2006 related to the disposal of U.S. facilities held for sale. Other investment assets in the first half of 2007 for a use of funds of \$2.7 million included deferred acquisition costs of \$4.8 million. Other investment assets in the first half of 2006 generated proceeds of \$8.5 million primarily from the collection of notes receivable and the sale of Omnicare shares.

**Cash provided by financing activities** was \$80.4 million in the first half of 2007 compared to \$5.1 million in the first half of 2006. The financing activities for the first half of 2007 included the issuance of new long-term debt in the first quarter primarily to finance the March 2007 income taxes owing on the distribution of ALC and the issuance of the 2014 Debentures in the second quarter. Distributions to unitholders in the first half of 2007 were \$43.1 million and included \$12.8 million related to distributions declared in 2006 and paid on January 15, 2007. The financing activities in the first half of 2006 related primarily to the issuance of long-term debt to finance acquisitions.

## Capital Structure

	<b>June 30</b>	<b>Dec. 31</b>
	<b>2007</b>	<b>2006</b>
<i>(millions of dollars unless otherwise noted)</i>		
<b>REIT and Exchangeable LP units</b>	<b>314.0</b>	311.5
<b>Equity component of convertible debentures</b>	<b>8.2</b>	–
<b>Retained Earnings (Deficit)</b>		
Balance at beginning of period	(336.6)	202.0
Adjustment due to adoption of new accounting standards	1.2	–
Earnings (loss) for the period	43.7	(35.7)
Purchase of shares in excess of book value	–	(3.4)
Distribution of ALC	–	(476.5)
Unitholder distributions	(39.0)	(13.0)
Shareholder dividends	–	(10.0)
	<b>(330.7)</b>	<b>(336.6)</b>
<b>Accumulated other comprehensive income</b>	<b>0.4</b>	1.4
<b>Unitholders' (deficiency)</b>	<b>(8.1)</b>	<b>(23.7)</b>
<b>Number of Units Outstanding</b> (at period end)		
REIT Units	<b>60,799,167</b>	59,178,781
Exchangeable LP Units	<b>9,555,632</b>	11,026,222
	<b>70,354,799</b>	70,205,003
<b>Long-term Debt</b> <sup>(1)</sup>		
Debt	<b>917.2</b>	851.2
Convertible debentures (face value)	<b>115.0</b>	–
	<b>1,032.2</b>	851.2
<b>Adjusted Gross Book Value (AGBV)</b> <sup>(2)</sup>		
Total Assets	<b>1,331.4</b>	1,315.2
Accumulated depreciation and amortization	<b>428.9</b>	439.0
Incremental value	<b>675.0</b>	675.0
	<b>2,435.3</b>	2,429.2
<b>Long-term Debt to AGBV</b>		
Excluding convertible debentures	<b>37.7%</b>	35.0%
Including convertible debentures	<b>42.4%</b>	N/A
<b>US/Canadian dollar exchange rate</b> (at period end)	<b>1.0654</b>	1.1654

<sup>(1)</sup> Long-term debt includes current maturities and excludes deferred financing charges.

<sup>(2)</sup> Adjusted Gross Book Value is defined in the REIT's Deed of Trust, and in general is determined by taking total reported assets at a period in time, adding back accumulated depreciation and amortization and making a one-time adjustment for incremental value of the assets at the effective date of the Arrangement.

	<b>Number of Units</b>	<b>Closing</b>
	<b>Outstanding</b>	<b>Market</b>
		<b>Value</b> <sup>(1)</sup>
<b>Unit Information (at July 31, 2007)</b>		
REIT Units (TSX symbol: EXE.UN)	<b>60,836,137</b>	\$14.80
Exchangeable LP Units	<b>9,529,568</b>	N/A
	<b>70,365,705</b>	

<sup>(1)</sup> Per the Toronto Stock Exchange.

The closing rates used to translate assets and liabilities of the U.S. operations were 1.0654 at June 30, 2007, and 1.1654 at December 31, 2006. As a result of the stronger Canadian dollar at the end of June 2007, the assets of the REIT's U.S. operations declined by approximately \$80.2 million and the liabilities declined by approximately \$77.0 million, with the net change resulting in a decrease in the foreign currency translation adjustment of \$3.2 million included in accumulated other comprehensive income.

### **Long-term Debt**

Long-term debt, including current maturities, was \$999.3 million at June 30, 2007, and was net of \$24.3 million of deferred financing costs. Due to a prospective change in accounting policy effective January 1, 2007, deferred financing costs were reclassified from other assets to long-term debt on the balance sheet. The balance of long-term debt excluding deferred financing costs was \$1,023.6 million, and reflected an increase of \$172.4 million from \$851.2 million at December 31, 2006. In January 2007 ECI and EHSI issued new mortgage financings of \$26.3 million and \$105.4 million (US\$90.0 million), respectively. In addition, the REIT issued the 2014 Debentures of which \$106.3 million was classified as debt. These \$238.0 million of debt issuances were partially offset by scheduled debt repayments of \$5.5 million and a decrease of \$60.1 million due to the foreign exchange rate. A description of the new debt issued is provided under the heading "Significant Developments – Financings". EHSI's US\$90.0 million, 2012 CMBS Financing, was used primarily to pay current taxes owing on the distribution of ALC in March 2007. A portion of the proceeds from the 2014 Debentures was used to repay the US\$46.0 million balance outstanding on EHSI's Credit Facility. The balance of proceeds from new debt issuances will be used to fund future strategic acquisitions and internal growth expenditures, and for other general corporate purposes. Deferred financing charges were \$24.3 million at June 30, 2007, of which \$2.2 million had been amortized to financing costs during the first half of 2007.

In order for the REIT to meet its monthly distributions, management decided to limit the amount of debt that may be subject to changes in interest rates. As a result, all of the long-term debt outstanding at June 30, 2007, was at fixed rates. The weighted average interest rate of all long-term debt at June 30, 2007, based on the face value of the debt, was approximately 6.8% compared to 7.2% at December 31, 2006.

Extendicare REIT's financial position continues to be strong, with long-term debt (at face value and including current maturities) representing 42.4% of AGBV at June 30, 2007. Excluding the 2014 Debentures, debt to AGBV was 37.7% at June 30, 2007.

The amount available to be borrowed under EHSI's Credit Facility is the lesser of: (1) 60% of the appraised values of the nursing facilities collateralizing the Credit Facility, or (2) an amount based on the actual net cash flow of these facilities for the last 12 months. The amount available to be borrowed as of June 30, 2007 was US\$97.8 million, of which EHSI had US\$20.4 million securing outstanding letters of credit, leaving the unused portion of the Credit Facility at US\$77.4 million as of June 30, 2007.

EHSI was in compliance with all of its respective financial covenants as of June 30, 2007.

On June 29, 2007, Extendicare amended its RBC Credit Facility to increase its availability from \$50.0 million to \$70.0 million. It is primarily used to back letters of credit, of which there were \$45.1 million issued and outstanding as at June 30, 2007, to secure Extendicare's pension obligations. On July 5, 2007, the additional availability obtained was used to secure \$18.8 million of letters of credit in connection with the sale of Extendicare's investment in Crown Life, leaving \$6.1 million available.

### **Foreign Currency Forward Contracts**

EHSI entered into foreign currency forward contracts to limit the exposure to converting its U.S. cash flow into Canadian dollars for distribution to the REIT unitholders. Under an October 2006 agreement that covers a 36-month period commencing on December 5, 2006, EHSI locked in the purchase of Canadian dollars at the fixed exchange rate of 1.1141 in exchange for US\$4.0 million per month. In June, 2007, EHSI entered into an additional foreign currency forward contract to cover the 7-month period from December 2009 to June 2010. This contract provides for a range of exchange rates on acquiring Canadian dollars for US\$4.0 million each month, with the floor rate set at 1.00 and the ceiling rate set at 1.1050, and the current exchange rate is applied if it falls between these two rates.

These foreign currency forward contracts are not designated as hedging instruments for accounting purposes and, therefore, future market value adjustments on these derivatives will be reflected through the statement of earnings. As of June 30, 2007, the fair value of the foreign currency forward contracts was an asset of \$6.2 million (US\$5.8 million) compared to a liability of \$5.3 million (US\$4.5 million) at December 31, 2006.

## **Future Liquidity and Capital Resources**

Management believes that cash from operations and from anticipated growth, together with available bank credit facilities, will be sufficient for the foreseeable future to support ongoing operations and capital expenditures, service debt obligations and pay declared distributions to unitholders. Property and equipment expenditures, excluding acquisitions, are anticipated to be approximately \$91.0 million in 2007, with \$57.0 million directed towards organic growth initiatives and the remaining \$34.0 million towards sustaining and upgrading existing property and equipment assets.

At June 30, 2007, EHSI had US\$77.4 million available under its Credit Facility and cash on hand of US\$66.2 million. The Canadian operations had cash on hand of \$80.8 million and available bank lines of \$6.1 million. On July 5, 2007, Extencicare received cash of \$40.0 million on the sale of its investment in Crown Life.

At June 30, 2007, outstanding capital expenditure commitments for EHSI, totalled \$21.3 million (US\$20.0 million). Included in EHSI's outstanding commitments was US\$6.5 million related to two expansion projects estimated to cost approximately US\$13.1 million, of which US\$5.5 million was spent through to June 30, 2007.

On August 1, 2007, EHSI acquired a Wisconsin assisted living facility (56 units) for US\$5.5 million in cash.

In July 2007 EHSI entered into an agreement to acquire a 99-bed skilled nursing facility in Milwaukee for cash of US\$7.5 million. The acquisition is expected to close in the fourth quarter of 2007.

The completion of the Tendercare acquisition is subject to certain customary regulatory approvals, including approval by HUD. Extencicare REIT is working towards closing the transaction by the end of 2007. The transaction is structured to be payable with cash of US\$122.5 million plus the assumption of US\$80.0 million of debt, prior to working capital and the cost of the two development projects. Management will determine the optimum financing of the acquisition prior to closing.

## **Distributions**

The current policy of each of the REIT and Extencicare LP is to pay distributions of \$0.0925 per REIT Unit and Exchangeable LP Unit, respectively, to the holders thereof on a monthly basis. The declaration and payment of future distributions is subject to the discretion of the Board of Trustees and will be dependent upon a number of factors including results of operations, requirements for capital expenditures and working capital, future financial prospects of the REIT, debt covenants and obligations, and any other factors deemed relevant by the Board of Trustees. If the Trustees determine that it would be in the REIT's best interests, they may reduce, for any period, the percentage of Distributable Income to be distributed, which will result in corresponding reductions in distributions on Exchangeable LP Units.

Approximately 73% of Extencicare REIT's distributions in 2006 were characterized as non-taxable returns of capital in Extencicare REIT's indirect investment in its subsidiaries. Management believes that it is likely that approximately 70% of Extencicare REIT's distributions in 2007 will also be characterized as non-taxable returns of capital. To the extent a portion of the distributions paid in 2007 are dividends, such dividends paid to Canadian residents will be eligible dividends as per the Canadian Income Tax Act.

In the first half of 2007, Extencicare REIT generated Distributable Income of \$55.0 million and Adjusted Funds from Operations of \$48.3 million. The Board of Trustees of the REIT declared distributions totalling \$39.0 million in the first half of 2007, representing \$36.6 million in cash and \$2.4 million by way of issued units under a distribution reinvestment plan, to holders of REIT Units and Exchangeable LP Units.

There are a number of factors that affect the quarterly funds generated for distribution that the Board of Trustees takes into consideration in determining the monthly distributions for the year. Factors affecting quarterly trends in earnings are discussed under the headings "2007 Second Quarter Results" and "2007 Six Months Results". Facility maintenance capital expenditures made in the first half of 2007 of \$13.8 million were behind the expected annual run rate \$34.0 million based on the current level of operations.

The following tables provide a reconciliation of the net earnings (loss) to Funds from Operations, Distributable Income and Adjusted Funds from Operations for the three months ended June 30, 2007.

<i>(thousands of dollars unless otherwise noted)</i>	<b>Three months ended June 2007</b>		
	<b>Continuing Operations</b>	<b>Discontinued Operations</b>	<b>Total</b>
<b>Net earnings (loss)</b>	<b>28,059</b>	<b>250</b>	<b>28,309</b>
<b>Adjustments:</b>			
Depreciation and amortization expense	12,336	(1)	12,335
Deduct depreciation for furniture, fixtures, equipment and computers	(3,509)	–	(3,509)
Accretion expense	331	16	347
Gain on derivative financial instruments and foreign exchange	(15,557)	–	(15,557)
Loss (gain) from asset impairment, disposals and other items	(2,192)	(170)	(2,362)
Current tax provision (recovery) on loss (gain) from derivatives, foreign exchange, asset impairment, disposals and other items	7	2,471	2,478
Future income taxes	5,921	(2,394)	3,527
Share of undistributed equity accounted earnings	(961)	–	(961)
<b>Funds from operations, before working capital changes <sup>(1)</sup></b>	<b>24,435</b>	<b>172</b>	<b>24,607</b>
Amortization of deferred financing costs	1,159	–	1,159
Principal portion of government capital funding payments	514	–	514
<b>Distributable income <sup>(1)</sup></b>	<b>26,108</b>	<b>172</b>	<b>26,280</b>
Additional maintenance capital expenditures <sup>(2)</sup>	(4,249)	–	(4,249)
<b>Adjusted funds from operations <sup>(1)</sup></b>	<b>21,859</b>	<b>172</b>	<b>22,031</b>
<b>Funds from Operations per unit (\$)</b>			
Basic	0.347	0.003	<b>0.350</b>
Diluted	0.345	0.003	<b>0.348</b>
<b>Distributable Income per unit (\$)</b>			
Basic	0.371	0.003	<b>0.374</b>
Diluted	0.368	0.003	<b>0.371</b>
<b>Adjusted Funds from Operations per unit (\$)</b>			
Basic	0.311	0.002	<b>0.313</b>
Diluted	0.309	0.002	<b>0.311</b>
<b>Distributions</b>			
Declared			<b>19,519</b>
Declared per unit (\$)			<b>0.2775</b>
<b>Weighted Average Number of Units (thousands)</b>			
Basic			<b>70,324</b>
Diluted			<b>70,896</b>

<sup>(1)</sup> "Funds from operations", "distributable income" and "adjusted funds from operations" are not recognized measures under GAAP and do not have a standardized meaning prescribed by GAAP. Refer to the discussion of non-GAAP measures.

<sup>(2)</sup> Represents total facility maintenance capital expenditures of \$7,758 less depreciation for furniture, fixtures, equipment and computers of \$3,509 already deducted in determining Distributable Income.

The following tables provide a reconciliation of the net earnings (loss) to Funds from Operations, Distributable Income and Adjusted Funds from Operations for the six months ended June 30, 2007.

	<b>Six months ended June 2007</b>		
<i>(thousands of dollars unless otherwise noted)</i>	<b>Continuing Operations</b>	<b>Discontinued Operations</b>	<b>Total</b>
<b>Net earnings (loss)</b>	<b>47,288</b>	<b>(3,613)</b>	<b>43,675</b>
<b>Adjustments:</b>			
Depreciation and amortization expense	25,020	103	25,123
Deduct depreciation for furniture, fixtures, equipment and computers	(7,040)	–	(7,040)
Accretion expense	672	37	709
Gain on derivative financial instruments and foreign exchange	(17,054)	–	(17,054)
Loss (gain) from asset impairment, disposals and other items	(2,192)	5,675	3,483
Current tax provision (recovery) on loss (gain) from derivatives, foreign exchange, asset impairment, disposals and other items	764	127	891
Future income taxes	5,871	(2,372)	3,499
Share of undistributed equity accounted earnings	(1,541)	–	(1,541)
<b>Funds from operations, before working capital changes <sup>(1)</sup></b>	<b>51,788</b>	<b>(43)</b>	<b>51,745</b>
Amortization of deferred financing costs	2,238	–	2,238
Principal portion of government capital funding payments	1,024	–	1,024
<b>Distributable income <sup>(1)</sup></b>	<b>55,050</b>	<b>(43)</b>	<b>55,007</b>
Additional maintenance capital expenditures <sup>(2)</sup>	(6,738)	–	(6,738)
<b>Adjusted funds from operations <sup>(1)</sup></b>	<b>48,312</b>	<b>(43)</b>	<b>48,269</b>
<b>Funds from Operations per unit (\$)</b>			
Basic	0.737	(0.001)	<b>0.736</b>
Diluted	0.734	–	<b>0.734</b>
<b>Distributable Income per unit (\$)</b>			
Basic	0.783	–	<b>0.783</b>
Diluted	0.780	–	<b>0.780</b>
<b>Adjusted Funds from Operations per unit (\$)</b>			
Basic	0.687	–	<b>0.687</b>
Diluted	0.685	(0.001)	<b>0.684</b>
<b>Distributions</b>			
Declared			<b>39,012</b>
Declared per unit (\$)			<b>0.5550</b>
<b>Weighted Average Number of Units (thousands)</b>			
Basic			<b>70,279</b>
Diluted			<b>70,568</b>

<sup>(1)</sup> "Funds from operations", "distributable income" and "adjusted funds from operations" are not recognized measures under GAAP and do not have a standardized meaning prescribed by GAAP. Refer to the discussion of non-GAAP measures.

<sup>(2)</sup> Represents total facility maintenance capital expenditures of \$13,778 less depreciation for furniture, fixtures, equipment and computers of \$7,040 already deducted in determining Distributable Income.

The following tables provide a reconciliation of the cash provided by operations to Distributable Income and Adjusted Funds from Operations for the three and six months ended June 30, 2007.

<i>(thousands of dollars)</i>	<b>Three months ended June 2007</b>	<b>Six months ended June 2007</b>
<b>Cash provided by operations</b>	<b>23,334</b>	<b>53,681</b>
<b>Add (deduct):</b>		
Net change in operating assets and liabilities	900	(312)
Current tax recovery on loss (gain) from derivatives, foreign exchange, asset impairment, disposals and other items	2,478	891
Net provisions and payments for self-insured liabilities	2,540	6,245
Depreciation on furniture, fixtures, equipment and computers	(3,509)	(7,040)
Other	23	518
Principal portion of government capital funding payments	514	1,024
<b>Distributable income</b> <sup>(1)</sup>	<b>26,280</b>	<b>55,007</b>
Additional maintenance capital expenditures <sup>(2)</sup>	(4,249)	(6,738)
<b>Adjusted funds from operations</b> <sup>(1)</sup>	<b>22,031</b>	<b>48,269</b>

(1) "Funds from operations", "distributable income" and "adjusted funds from operations" are not recognized measures under GAAP and do not have a standardized meaning prescribed by GAAP. Refer to the discussion of non-GAAP measures.

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

### Contractual Obligations

The table below provides aggregated information about the contractual obligations at June 30, 2007, excluding self-insured liabilities, pension and other retirement benefit obligations. As well, it excludes conditional asset retirement obligations totalling \$20.4 million as of June 30, 2007, due to the uncertainty as to the timing of payments to be made under these obligations.

<i>(millions of dollars)</i>	<b>Total</b>	<b>To the end of 2007</b>	<b>2008 – 2009</b>	<b>2010– 2011</b>	<b>After 2011</b>
<b>REIT convertible debentures (face value)</b>	115.0	–	–	–	115.0
<b>Canadian Subsidiary Operations</b>					
Long-term debt	152.7	2.9	27.5	12.6	109.7
Capital lease obligations	257.8	6.5	25.9	25.8	199.6
Operating lease obligations	7.6	1.0	3.6	2.9	0.1
<b>United States Subsidiary Operations</b>					
Long-term debt	634.6	4.2	3.5	535.1	91.8
Operating lease obligations	42.1	3.8	14.3	10.4	13.6
Purchase obligations	21.3	21.3	–	–	–

In addition to the operating lease amounts identified in the table above, EHSI has made guarantees to Triple S Investment Company (Triple S) for the payment of operating leases by Senior Health Properties – Texas, Inc. (Senior Health – Texas). As well, EHSI remains party to ALC's master leases with LTC Properties, Inc. (LTC) following the Arrangement. For further details on these commitments, refer to "Off-balance Sheet Arrangements".

### Accrual for Self-insured Liabilities

At June 30, 2007, the accrual for self-insured general and professional liabilities was \$48.8 million compared to \$59.8 million at the beginning of the year. Claims payments, net of the current period provision, decreased the accrual by \$6.3 million in the first half of 2007, and the change in the foreign exchange rate decreased it by \$4.7 million. The accrual for self-insured liabilities includes estimates of the costs of both reported claims and claims incurred but not yet reported. Provisions recorded in the first half of 2007 and 2006 for potential general and professional liability claims were \$6.1 million and \$6.4 million, respectively. Payments for self-insured liabilities during the first half of 2007 and 2006 were \$12.3 million and \$9.9 million, respectively. The increase in payments in 2007 over 2006 related to ceased operations. Payments made for resident care liability claims have been in excess of the current accrual levels because claims related to ceased operations are still being settled, for which provisions were previously recorded. EHSI exited the nursing home markets of the highly litigious States of Florida and Texas in 2000 and 2001, respectively. Payments made for these claims have tapered off, reflecting the wind-down of claims associated with these ceased operations. Exclusive of claims pertaining to these disposed operations, the growth of claims has increased, but within management's projections. An independent

actuarial review was completed as part of the 2006 year-end financial reporting process, which confirmed the adequacy of the balance of the reserves for resident care liability claims as at December 31, 2006. Management estimates that \$18.6 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 in management's control and therefore estimates could change in the future. Management believes Extencicare has provided sufficient reserves as of June 30, 2007 for estimated costs of self-insured liabilities.

Extencicare invests funds to support the accrual for self-insured liabilities. These funds are reported in other assets and totalled \$41.3 million at June 30, 2007 compared to \$54.7 million at the end of 2006. Most of the risks that Extencicare self-insures are long-term in nature and accordingly, claims payments for any particular policy year occur over a long period of time. Management believes that Extencicare has sufficient cash resources to meet its estimated current claims payment obligations.

## **Off-balance Sheet Arrangements**

### **Triple S Leases**

EHSI has made guarantees to Triple S for the payment of operating leases by Senior Health – Texas. EHSI leases 12 nursing properties from Triple S that are subleased to Senior Health – Texas. Under the terms of the lease with Triple S, EHSI remains responsible for lease payments and other obligations as defined in the lease agreement. Pursuant to the Triple S lease, EHSI is liable to Triple S should there be any default in the payment of rent by Senior Health – Texas. Senior Health – Texas continues to be current in its payments. The lease commitment to Triple S is US\$1.9 million annually until the lease expires on February 28, 2012. In December 2006 EHSI made the decision in conjunction with Triple S to dispose of these facilities, as such they have been reported as discontinued operations.

### **ALC Master Leases**

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

The Master Leases provide for an initial 10-year term and three successive 10-year lease terms at the option of the lessee. There are no significant economic penalties if the renewal options are not exercised. The aggregate minimum rental payments for the LTC leases for the calendar years 2007 and 2008 are US\$10.2 million and US\$10.7 million, respectively. The minimum rent will increase by 2% over the prior year's minimum rent for each of the calendar years 2009 through 2014. Annual minimum rent during any renewal term will increase by a minimum of 2% over the minimum rent of the immediately preceding year.

### **Credit and Interest Rates**

In order for the REIT to meet its monthly distributions, management decided to limit the amount of debt that may be subject to changes in interest rates. As a result, with the exception of EHSI's Credit Facility, all of the long-term debt is at fixed rates. There was nothing drawn on EHSI's Credit Facility at June 30, 2007. The weighted average interest rate of all long-term debt at June 30, 2007, based on the face value of the debt, was approximately 6.8% compared to 7.2% at December 31, 2006. The weighted average interest rate of long-term debt at June 30, 2007 for the Canadian and U.S. operations was 7.1% and 6.7%, respectively, compared to 8.6% and 6.7% at December 31, 2006, respectively.

## Changes in Accounting Policies

The REIT's significant accounting policies are set out in *note 1* of the audited consolidated financial statements of the REIT's 2006 Annual Report. During 2007 the REIT adopted the following new accounting policy as a result of new accounting standards, which are more fully described in *note 2* of the unaudited consolidated financial statements for the six months ended June 30, 2007.

### Financial Instruments, Hedges and Comprehensive Income

Effective January 1, 2007, the REIT adopted three new CICA accounting standards: Section 3855 "Financial Instruments – Recognition and Measurement"; Section 3865 "Hedges"; and Section 1530 "Comprehensive Income". These accounting standards introduced new requirements for the recognition and measurement of financial instruments, the application of hedge accounting and the reporting of comprehensive income designed to harmonize Canadian accounting standards with U.S. and International Financial Reporting Standards. The new standards require financial assets and liabilities, including derivative financial instruments, to be carried at fair value. The fair values are recognized in opening equity and results for prior periods are not restated. Unrealized gains and losses on financial assets that are designated as available for sale, unrealized foreign currency translation amounts arising from self-sustaining foreign operations, and changes in the fair value of cash flow hedging instruments, are recorded as other comprehensive income and form part of unitholders' equity.

The following reflects the adjustments made on January 1, 2007, and the impact during the first half to 2007 to the REIT's balance sheet to adopt the new requirements.

<i>(thousands of dollars)</i>	<b>June 30 2007</b>
<b>Investments Held for Self-insured Liabilities</b>	
Transition adjustment on adoption – unrealized gain on available-for-sale securities	376
Other comprehensive income during the period	
Net unrealized (loss) on available-for-sale securities	173
Reclassification of gain on available-for-sale securities to earnings	(351)
	<b>198</b>
<b>Equity Accounted Investments</b>	
Transition adjustment on adoption of financial instruments	
Retained earnings	1,208
Reclassification of foreign currency translation adjustments to other comprehensive income	(4,013)
Other comprehensive income	8,285
Net change in other comprehensive income during the period	
Net unrealized gain on financial instruments	(2,240)
Net change in foreign currency translation adjustments	(2,331)
	<b>909</b>
<b>Deferred financing costs – Transition adjustment on adoption – amortization</b>	<b>(11)</b>
<b>Future Income Tax, Net Asset (Liability)</b>	
Transition adjustment on adoption	(127)
Other comprehensive income during the period	62
	<b>(65)</b>
<b>Retained Earnings (Deficit)</b>	
Transition adjustment on adoption of financial instruments	
Amortization of deferred financing costs (net of tax of \$4)	(7)
Share of equity accounted investments	1,208
	<b>1,201</b>

	<b>June 30</b>
<i>(thousands of dollars)</i>	<b>2007</b>
<b>Accumulated Other Comprehensive Income</b>	
Transition adjustment on adoption of financial instruments	
Unrealized gain on available-for-sale securities (net of tax of \$131)	245
Net change in unrealized gains (losses) on available-for-sale securities (net of tax of \$62)	(116)
Reclassification of foreign currency translation adjustments	(2,596)
Net change in foreign currency translation adjustments	(828)
	<u>(3,295)</u>
Share of equity accounted other comprehensive income	
Transition adjustment on adoption of financial instruments	4,272
Reclassification of foreign currency translation adjustments	4,013
Net change in foreign currency translation adjustments	(2,331)
Net change in unrealized gains (losses) on financial instruments	(2,240)
	<u>3,714</u>
Balance at end of period	<u>419</u>

### Cash Flow Statements

Effective January 1, 2007, CICA amended Section 1540 "Cash Flow Statements" to modify the disclosure requirements pertaining to cash distributions made in accordance with contractual agreements or relevant constating documents, such as disclosing the terms and conditions in determining the cash distributions made and the extent to which the distributions are non-discretionary.

### New Accounting Policies

The following are new accounting policies that have been issued, and will impact the REIT at a future date.

In December 2006 the CICA issued Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation", which together replace Section 3861 "Financial Instruments – Disclosure and Presentation". These new standards carry forward unchanged the presentation requirements and revise and enhance the disclosure requirements, such as specific disclosures to be made when an entity defaults or breaches a loan agreement. The new sections are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, with earlier adoption encouraged.

In December 2006 the CICA issued Section 1535 "Capital Disclosures", which requires, among other things, disclosure of an entity's objectives, policies, and processes for managing capital, and quantitative data about what the entity regards as capital. Section 3862 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, with earlier adoption encouraged.

### Additional Information

Additional information about Extencicare REIT, including the Annual Information Form may be found on the SEDAR website at [www.sedar.com](http://www.sedar.com) and on Extencicare's website at [www.extencicare.com](http://www.extencicare.com). A copy of this document and other public documents of the REIT are available upon request to the Secretary.

## **FORWARD-LOOKING STATEMENTS**

Information provided by Extendicare REIT from time to time, including this Interim Report, contains or may contain forward-looking statements concerning anticipated future events, results, circumstances, economic performance or expectations with respect to the REIT and its subsidiaries, including its business operations, business strategy, and financial condition. Forward-looking statements can be identified because they generally contain the words “anticipate”, “believe”, “estimate”, “expect”, “objective”, “project” or a similar expression.

Forward-looking statements reflect management's beliefs and assumptions and are based on information currently available, and the REIT assumes no obligation to update any forward-looking statement. These statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of the REIT to differ materially from those expressed or implied in the statements. In addition to the assumptions and other factors referred to specifically in connection with these statements, such factors are identified in the REIT's public filings with Canadian and United States securities regulators and include, but are not limited to, the following: changes in the health care industry in general and the long-term care industry in particular because of political and economic influences; changes in regulations governing the industry and the compliance of the REIT and its subsidiaries with such regulations; changes in government funding levels for health care services; changes in tax laws; resident care litigation, including exposure for punitive damage claims and increased insurance costs, and other claims asserted against the REIT and its subsidiaries; the ability to maintain and increase census levels; changes in foreign exchange rates; the ability to attract and retain qualified personnel; the availability and terms of capital to fund capital expenditures; changes in competition; and demographic changes.

Given these risks and uncertainties, readers are cautioned not to place undue reliance on the REIT's forward-looking statements.

**Extencicare Real Estate Investment Trust**  
**CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)**

	Three months ended June 30		Six months ended June 30	
<i>(thousands of dollars except per unit/share amounts)</i>	2007	2006 revised*	2007	2006 revised*
<b>Revenue</b>				
Nursing and assisted living centres				
United States	289,533	276,989	595,176	555,757
Canada	104,114	99,221	203,674	194,373
Outpatient therapy – United States	3,241	3,344	6,495	6,500
Home health – Canada	35,023	35,557	70,403	69,002
Other	11,995	10,087	25,002	21,021
	<b>443,906</b>	425,198	<b>900,750</b>	846,653
<b>Operating expenses</b>	<b>370,943</b>	356,872	<b>754,867</b>	713,165
<b>Administrative costs</b>	<b>15,897</b>	16,394	<b>32,967</b>	36,374
<b>Lease costs</b>	<b>3,033</b>	3,523	<b>6,249</b>	6,935
	<b>389,873</b>	376,789	<b>794,083</b>	756,474
<b>Earnings before undernoted</b>	<b>54,033</b>	48,409	<b>106,667</b>	90,179
Depreciation and amortization	12,336	11,877	25,020	23,959
Accretion expense	331	315	672	635
Interest, net	17,779	14,900	33,974	29,069
Gain on derivative financial instruments and foreign exchange <i>(note 10)</i>	(15,557)	(359)	(17,054)	(462)
Loss (gain) from restructuring charges, asset disposals and other items <i>(note 4)</i>	(2,192)	3,807	(2,192)	5,728
<b>Earnings from continuing health care operations before income taxes</b>	<b>41,336</b>	17,869	<b>66,247</b>	31,250
<b>Income taxes</b>				
Current	8,317	5,912	14,629	14,000
Future	5,921	366	5,871	(3,990)
Taxes associated with reorganization	–	15,570	–	15,570
	<b>14,238</b>	21,848	<b>20,500</b>	25,580
<b>Earnings (loss) from continuing health care operations</b>	<b>27,098</b>	(3,979)	<b>45,747</b>	5,670
<b>Share of equity accounted earnings <i>(note 8)</i></b>	<b>961</b>	1,603	<b>1,541</b>	2,453
<b>Earnings (loss) from continuing operations</b>	<b>28,059</b>	(2,376)	<b>47,288</b>	8,123
<b>Earnings (loss) from discontinued operations, net of income taxes <i>(note 5)</i></b>	<b>250</b>	18	<b>(3,613)</b>	3,237
<b>Net earnings (loss)</b>	<b>28,309</b>	(2,358)	<b>43,675</b>	11,360
<b>Basic and Diluted Earnings (Loss) per Unit/Subordinate Voting Share <i>(note 12)</i></b>				
Earnings (loss) from continuing operations	<b>0.40</b>	(0.03)	<b>0.67</b>	0.12
Net earnings (loss)	<b>0.40</b>	(0.03)	<b>0.62</b>	0.17
<b>Basic and Diluted Earnings (Loss) per Multiple Voting Share <i>(note 12)</i></b>				
Earnings (loss) from continuing operations		(0.06)		0.07
Net earnings (loss)		(0.06)		0.12

\* See note 1.

**Extencicare Real Estate Investment Trust**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Three months ended June 30		Six months ended June 30	
<i>(thousands of dollars)</i>	2007	2006	2007	2006
<b>Cash Provided by (Used in) Operations</b>				
Net earnings (loss)	28,309	(2,358)	43,675	11,360
Adjustments for:				
Depreciation and amortization	12,335	16,774	25,123	33,744
Provision for self-insured liabilities	3,790	3,596	6,054	6,367
Payments for self-insured liabilities	(6,330)	(5,380)	(12,299)	(9,893)
Future income taxes	3,527	14,070	3,499	12,240
Undistributed share of earnings from equity investments	(961)	(1,603)	(1,541)	(2,453)
Gain on derivative financial instruments and foreign exchange <i>(note 10)</i>	(15,557)	(359)	(17,054)	(462)
Loss (gain) from restructuring charges, asset disposals and other items <i>(note 4)</i>	(2,192)	3,807	(2,192)	5,728
Loss (gain) from asset impairment, disposals and other items from discontinued operations <i>(note 5)</i>	(170)	3,510	5,675	4,429
Other	1,483	392	2,429	392
	24,234	32,449	53,369	61,452
Net change in operating assets and liabilities				
Accounts receivable	3,815	(15,939)	4,694	(22,178)
Inventories, supplies and prepaid expenses	(663)	1,577	(5,527)	(4,593)
Accounts payable and accrued liabilities	(626)	7,352	(15,187)	22,921
Income taxes	(3,426)	(3,799)	16,332	(2,289)
	23,334	21,640	53,681	55,313
<b>Cash Provided by (Used in) Investment Activities</b>				
Property and equipment	(19,746)	(18,491)	(35,089)	(32,314)
Acquisitions <i>(note 3)</i>	(2,796)	–	(11,489)	(28,073)
Net proceeds from dispositions <i>(note 5)</i>	–	547	2,228	1,944
Return of equity investment <i>(note 8)</i>	41,637	–	41,637	–
Other assets	(2,012)	5,668	(2,666)	8,507
	17,083	(12,276)	(5,379)	(49,936)
<b>Cash Provided by (Used in) Financing Activities</b>				
Issue of long-term debt	115,000	–	246,695	–
Issue (repayment) on line of credit	(19,917)	(6,054)	–	19,349
Repayment of long-term debt	(2,663)	(2,469)	(5,421)	(4,954)
Decrease (increase) in investments held for self-insured liabilities	2,170	(1,100)	10,008	4,939
Purchase of shares for cancellation	–	(72)	–	(346)
Distributions/dividends paid	(18,205)	(3,302)	(43,050)	(6,589)
Transaction costs of reorganization <i>(notes 4 and 5)</i>	–	(5,438)	–	(7,639)
Financing costs	(6,088)	–	(9,950)	–
Income taxes paid re the distribution of ALC <i>(note 9)</i>	–	–	(120,220)	–
Other	3,162	572	2,323	368
	73,459	(17,863)	80,385	5,128
<b>Foreign exchange gain (loss) on cash held in foreign currency</b>	<b>(4,835)</b>	<b>(395)</b>	<b>(4,845)</b>	<b>(194)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>109,041</b>	<b>(8,894)</b>	<b>123,842</b>	<b>10,311</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>42,858</b>	<b>41,814</b>	<b>28,057</b>	<b>22,609</b>
<b>Cash and cash equivalents at end of period</b>	<b>151,899</b>	<b>32,920</b>	<b>151,899</b>	<b>32,920</b>
<b>Supplementary Information</b>				
Cash interest paid in determination of earnings	17,689	15,720	33,647	33,211
Cash taxes paid	12,068	15,794	116,513	22,132
Units issued pursuant to the dividend reinvestment plan	1,307	–	2,443	–

Cash distributions for REIT and Exchangeable LP units are at the discretion of the Board of Trustees.

**Extendicare Real Estate Investment Trust**  
**CONSOLIDATED BALANCE SHEETS**

<i>(thousands of dollars)</i>	<b>June 30 2007</b>	<b>December 31 2006</b>
<b>Assets</b>		
Current assets		
Cash and short-term investments	151,899	28,057
Invested assets	3,590	–
Accounts receivable, less allowances of \$17,967 and \$16,684, respectively	184,930	204,741
Income taxes recoverable	11,062	–
Future income tax assets	21,737	25,183
Inventories, supplies and prepaid expenses	26,756	20,048
	<b>399,974</b>	<b>278,029</b>
Property and equipment	698,555	729,274
Goodwill and other intangible assets	75,552	80,648
Other assets <i>(note 6)</i>	122,303	149,449
	<b>1,296,384</b>	<b>1,237,400</b>
Equity accounted investments	35,005	77,782
	<b>1,331,389</b>	<b>1,315,182</b>
<b>Liabilities and Unitholders' Deficiency</b>		
Current liabilities		
Accounts payable	25,488	52,583
Accrued liabilities	195,997	207,836
Accrual for self-insured liabilities	18,645	20,395
Current maturities of long-term debt <i>(note 9)</i>	13,536	13,423
Income taxes payable	–	95,558
	<b>253,666</b>	<b>389,795</b>
Accrual for self-insured liabilities	30,143	39,386
Long-term debt <i>(note 9)</i>	985,751	837,757
Other long-term liabilities	55,729	59,312
Future income tax liabilities	14,211	12,586
	<b>1,339,500</b>	<b>1,338,836</b>
Unitholders' deficiency	(8,111)	(23,654)
	<b>1,331,389</b>	<b>1,315,182</b>

**Extendicare Real Estate Investment Trust**  
**CONSOLIDATED STATEMENTS OF UNITHOLDERS' (DEFICIENCY)/SHAREHOLDERS' EQUITY**

Six months ended June 30

<i>(thousands of dollars for amounts)</i>	2007		2006	
	<i>Number</i>	<i>Amount</i>	<i>Number</i>	<i>Amount</i>
<b>Unit/Share Capital (note 11)</b>				
<b>REIT Units</b>				
Issued and outstanding at beginning of period	59,178,781	262,617		
Issued pursuant to Distribution Reinvestment Plan	139,579	2,280		
Converted from Exchangeable LP Units	1,480,807	6,584		
Issued and outstanding at end of period	60,799,167	271,481		
<b>Exchangeable LP Units</b>				
Issued and outstanding at beginning of period	11,026,222	48,931		
Issued pursuant to Distribution Reinvestment Plan	10,217	163		
Converted to REIT Units	(1,480,807)	(6,584)		
Issued and outstanding at end of period	9,555,632	42,510		
Equity portion of Convertible Debentures (note 9)		8,234		
<b>Class I Preferred Shares</b>				
Cumulative Redeemable, Series 2				
Issued and outstanding at beginning of period			88,805	2,219
Purchased pursuant to obligation			(4,500)	(113)
Issued and outstanding at end of period			84,305	2,106
Adjustable Dividend, Series 3				
Issued and outstanding at beginning of period			93,310	2,333
Converted to Series 4 shares			(3,400)	(85)
Issued and outstanding at end of period			89,910	2,248
Adjustable Dividend, Series 4				
Issued and outstanding at beginning of period			241,240	6,031
Issued on conversion of Series 3 shares			3,400	85
Issued and outstanding at end of period			244,640	6,116
Class II Preferred Shares, Series 1			382,979	6,319
<b>Subordinate Voting Shares</b>				
Issued and outstanding at beginning of period			56,018,395	262,258
Issued pursuant to options			159,125	876
Issued and outstanding at end of period			56,177,520	263,134
<b>Multiple Voting Shares</b>				
Issued and outstanding at beginning of period			11,791,433	29,340
Purchased pursuant to issuer bid			(13,000)	(32)
Issued and outstanding at end of period			11,778,433	29,308
		<b>322,225</b>		<b>309,231</b>
<b>Contributed surplus – fair value of stock options</b>		–		441
<b>Retained Earnings (Deficit)</b>				
Balance at beginning of period		(336,619)		202,017
Transition adjustment on adoption of financial instruments				
Amortization of deferred financing costs (net of tax of \$4) (note 2)		(7)		–
Share of equity accounted investments (note 2)		1,208		–
Earnings for the period		43,675		11,360
Purchase of shares in excess of book, net		–		(201)
Distributions/dividends declared		(39,012)		(6,611)
Balance at end of period		(330,755)		206,565
<b>Accumulated Other Comprehensive Income</b>				
Balance at beginning of period				
Transition adjustment on adoption of financial instruments				
Unrealized gain on available-for-sale securities (net of tax of \$131) (note 2)		245		–
Share of other comprehensive income of equity accounted investments (note 2)		4,272		–
Reclassification from foreign currency translation adjustments		1,417		(24,372)
Net change in unrealized gains (losses) on available-for-sale securities (net of tax of \$62)		(116)		–
Net change in foreign currency translation adjustments (net of tax of nil)		(828)		(17,770)
Net change in equity accounted other comprehensive income		(4,571)		–
Balance at end of period		419		(42,142)
		<b>(8,111)</b>		<b>474,095</b>

**Extendicare Real Estate Investment Trust**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	Three months ended June 30		Six months ended June 30	
<i>(thousands of dollars)</i>	2007	2006	2007	2006
<b>Net earnings (loss)</b>	<b>28,309</b>	(2,358)	<b>43,675</b>	11,360
<b>Other comprehensive income (loss), net of income taxes</b>				
Net unrealized gain on available-for-sale securities (net of tax of \$61 for the six months ended June 30 )	88	–	112	–
Reclassification of gain on available-for-sale securities to earnings (net of tax of \$123 for the six months ended June 30)	(37)	–	(228)	–
	<b>51</b>	–	<b>(116)</b>	–
Net change in unrealized foreign currency translation gains (losses) (net of nil tax)	(709)	(20,318)	(828)	(17,770)
Net change in share of equity accounted investment's other comprehensive income	(5,584)	–	(4,571)	–
	<b>(6,242)</b>	(20,318)	<b>(5,515)</b>	(17,770)
<b>Comprehensive income (loss)</b>	<b>22,067</b>	(22,676)	<b>38,160</b>	(6,410)

## Extendicare REIT – Notes to the Unaudited Consolidated Financial Statements

### 1. Basis of Presentation

The unaudited interim period consolidated financial statements of Extendicare Real Estate Investment Trust (“Extendicare REIT” or the “REIT”) have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include those of Extendicare Inc. (“Extendicare” or the “Company”), an indirect wholly owned subsidiary of Extendicare REIT. Health care operations are conducted through wholly owned subsidiaries, Extendicare Health Services, Inc. and its subsidiaries (collectively “EHSI”) in the United States, and Extendicare (Canada) Inc. and its subsidiaries (collectively “ECI”) in Canada. The preparation of financial data is based on accounting policies and practices consistent with those used in the preparation of the annual audited consolidated financial statements. All dollar amounts are in Canadian dollars unless otherwise indicated. These unaudited interim consolidated financial statements do not include all disclosures normally provided in annual consolidated financial statements and should be read together with the annual audited consolidated financial statements and the accompanying notes included in Extendicare REIT’s 2006 Annual Report.

Certain comparative figures for the 2006 reported periods have been reclassified to conform to the presentation in 2007 mainly for discontinued operations as described in *note 5*.

### 2. Change in Accounting Policy

Effective January 1, 2007, Extendicare adopted three new accounting standards issued by the Canadian Institute of Chartered Accountants (CICA): Handbook Section 1530, “Comprehensive Income”, Handbook Section 3855, “Financial Instruments – Recognition and Measurement”, and Handbook Section 3865, “Hedges”. Extendicare adopted these standards retroactively without restatement of prior periods.

#### *Comprehensive Income*

Section 1530 introduces comprehensive income, which consists of net income and other comprehensive income (OCI). OCI represents changes in unitholders’ equity during a period arising from transactions and other events with non-owner sources and includes unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations, and changes in the fair value of the effective portion of cash flow hedging instruments, if any. The REIT has included in its consolidated financial statements a consolidated statement of comprehensive income for the changes in these items during the three and six month periods ending June 30, 2007, while the cumulative changes in OCI are included in accumulated other comprehensive income (AOCI), which is presented as a new category of unitholders’ equity on the consolidated balance sheet.

#### *Financial Instruments – Recognition and Measurement*

Section 3855 establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities, including derivatives, be recognized on the consolidated balance sheet when the REIT becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. Under this standard, all financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held for trading, available for sale, held to maturity, loans and receivables, or other financial liabilities. Transaction costs are expensed as incurred for financial instruments classified or designated as held for trading. For other financial instruments, transaction costs are capitalized on initial recognition. Financial assets and financial liabilities held for trading are measured at fair value with changes in those fair values recognized in other income. Financial assets held to maturity, loans and receivables, and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Available-for-sale financial assets are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in OCI, net of tax.

Derivative instruments are recorded on the consolidated balance sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts that are not closely related to the host contracts. Changes in the fair values of derivative instruments are recognized in net income with the exception of derivatives designated in effective cash flow hedges or hedges of foreign currency exposure of a net investment in a self-sustaining foreign operation. Section 3855 also provides an entity the option to designate a financial instrument as held for trading (the fair value option) on its initial recognition or upon adoption of the standard, even if the financial instrument, other than loans and receivables, was not acquired or incurred principally for the purpose of selling or repurchasing it in the near term. An instrument that is classified as held for trading by way of this fair value option must have reliable fair values.

## Extendicare REIT – Notes to the Unaudited Consolidated Financial Statements

### *Hedges*

Section 3865 specifies the criteria that must be satisfied in order for hedge accounting to be applied and the accounting for each of the permitted hedging strategies: fair value hedges, cash flow hedges and hedges of foreign currency exposures of net investments in self-sustaining foreign operations. Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item. In a fair value hedging relationship, the carrying value of the hedged item is adjusted for unrealized gains or losses attributable to the hedged risk and recognized in net earnings. Changes in the fair value of the hedged item, to the extent that the hedging relationship is effective, are offset by changes in the fair value of the hedging derivative, which is also recorded in net earnings. When hedge accounting is discontinued, the carrying value of the hedged item is no longer adjusted and the cumulative fair value adjustments to the carrying value of the hedged item are amortized to net earnings over the remaining term of the original hedging relationship. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is recognized in OCI while the ineffective portion is recognized in net earnings. When hedge accounting is discontinued, the amounts previously recognized in AOCI are reclassified to net earnings during the periods when the variability in the cash flows of the hedged item affects net earnings. Gains and losses on derivatives are reclassified immediately to net earnings when the hedged item is sold or early terminated. In hedging a foreign currency exposure of a net investment in a self-sustaining foreign operation, the effective portion of foreign exchange gains and losses on the hedging instruments is recognized in OCI and the ineffective portion is recognized in net earnings. The amounts previously recognized in AOCI are recognized in net earnings when there is a reduction in the hedged net investment as a result of a dilution or sale of the net investment, or reduction in equity of the foreign operation as a result of dividend distributions. Extendicare did not have hedges at December 31, 2006 or in the first half of 2007.

### *Impact of Adoption of Handbook Sections 1530, 3855, 3865*

- (a) Upon adoption of these new standards, Extendicare designated its cash and short-term investments as held for trading, which are measured at fair value. Accounts, notes and mortgages receivable were classified as loans and receivables, which are measured at amortized cost. Bank indebtedness, accounts payable, accrued liabilities, long-term debt and capital lease obligations were classified as other financial liabilities, which are measured at amortized cost.

The investments supporting Extendicare's self-insured general and professional liabilities were categorized as held to maturity and available for sale. The held-to-maturity investments were valued at amortized cost and continue to be valued at amortized cost subsequent to January 1, 2007, therefore there was no impact to Extendicare's financial statements for held-to-maturity securities. The available-for-sale securities, formerly at amortized cost, were designated as available for sale at January 1, 2007, with the resulting fair value transitional adjustment of \$0.2 million disclosed in AOCI, net of tax of \$0.1 million. Changes of \$0.1 million, net of tax of \$0.1 million, representing realized gains and increase in the fair value for available-for-sale securities were reported in OCI in the first half of 2007.

On June 29, 2007, Extendicare received securities from Crown Life which are recorded as invested assets. These assets have been categorized as available-for-sale and are held at fair market value. There was no impact on OCI at June 30, 2007.

- (b) At January 1, 2007, the unamortized cost of deferred financing costs related to the issue of long-term debt was adjusted to use the effective interest rate method to determine amortized cost and resulted in a transitional adjustment to retained earnings of \$7,000, net of future tax of \$4,000. Deferred financing costs, formerly included in other assets, are now included as part of the carrying value of long-term debt (\$24.3 million at June 30, 2007).
- (c) All derivative instruments, including embedded derivatives, are recorded in the statement of earnings at fair value unless exempted from derivative treatment as a normal purchase and sale. All changes in their fair value are recorded in earnings unless cash flow hedge accounting is used, in which case changes in fair value are recorded in OCI. Extendicare has elected to apply this accounting treatment for all embedded derivatives in host contracts entered into on or after January 1, 2003. The impact of the change in accounting policy related to embedded derivatives was not material.

## Extendicare REIT – Notes to the Unaudited Consolidated Financial Statements

Commercial mortgage backed securitization financings of EHSI (the “CMBS Financings”) were determined to contain embedded derivatives for prepayment options that were not closely related to the host debt and therefore, were bifurcated and separately fair valued. The host debt instruments were valued at amortized cost at January 1, 2007 and continue to be valued at amortized cost. The fair values of the prepayment options were determined to be immaterial and have not changed materially from January 1, 2007. Therefore, there is no adjustment to the consolidated financial statements in respect the CMBS Financings. Other mortgages financed since January 1, 2003 also contained prepayment options but were determined to be closely related to the host debt as the exercise price was approximately equal to the debt instrument’s amortized cost and therefore, no adjustment to the consolidated financial statements was required.

Extendicare utilizes foreign currency forward contracts, which are derivatives, to limit the exposure of converting U.S. cash flow into Canadian dollars. These forward contracts are not designated as hedges for accounting purposes and changes in their fair value are recorded in earnings.

- (d) As a transitional adjustment, Extendicare’s foreign currency adjustment account of \$1.4 million in unitholders’ equity, representing the accumulated net gain from the translation of its foreign operations, was reclassified to AOCI in unitholders’ equity. Changes to the unrealized foreign currency adjustment account are disclosed in OCI with comparative figures for the prior periods disclosed.
- (e) As required under the new accounting policies for Handbook Sections 1530, 3855, and 3865, Extendicare has included its share of changes to opening retained earnings, AOCI and OCI of its equity accounted investment, Crown Life Insurance Company (Crown Life). Extendicare’s share of transition adjustments for Crown Life increased retained earnings by \$1.2 million and increased AOCI by \$4.3 million, representing adjustments for available-for-sale investments and hedges of its net foreign investment. Extendicare’s share of Crown Life’s OCI for the first half of 2007 was a reduction of \$4.6 million. Extendicare’s investment in Crown Life was increased by \$0.9 million as a result of these changes.

### 3. Acquisitions

On January 5, 2007, EHSI completed the acquisition of a nursing facility (111 beds) that it was leasing in Ohio for cash of \$8.7 million (US\$7.4 million). On May 1, 2007, EHSI acquired a nursing facility (191 beds) in Wisconsin for cash of \$2.8 million (US\$2.5 million). EHSI plans to operate the facility as an 80-bed nursing facility and to relocate the remaining beds to another facility. The preliminary purchase price allocations are provided in the table below. EHSI will complete its valuation of net assets acquired by December 31, 2007. Based on this final valuation, the purchase price allocation for accounting purposes may be adjusted in future periods.

	Wisconsin		Ohio		Total	
	US\$	C\$	US\$	C\$	US\$	C\$
<i>(thousands of dollars)</i>						
Prepaid expenses	42	47	–	–	42	47
Property and equipment	2,467	2,741	5,500	6,449	7,967	9,190
Goodwill	–	–	1,914	2,244	1,914	2,244
Resident relationships	26	29	–	–	26	29
Total assets	2,535	2,817	7,414	8,693	9,949	11,510
Accrued liabilities	19	21	–	–	19	21
Purchase price	2,516	2,796	7,414	8,693	9,930	11,489

### 4. Loss (Gain) from Restructuring Charges, Asset Disposals and Other Items

For the six months ended June 30, 2007, Extendicare reported a gain of \$2.2 million on the sale of non-core real estate with no book value.

For the six months ended June 30, 2006, Extendicare reported a loss of \$5.7 million in the statement of earnings as a loss (gain) from restructuring charges, asset disposals and other items. Extendicare incurred pre-tax restructuring charges of \$5.0 million, representing advisory and other professional fees related to the start of the reorganization it underwent in 2006. Extendicare also recorded a \$0.8 million provision for severance and an unrealized loss of \$0.4 million to reduce the carrying value of its investment in Omnicare, Inc. Partly offsetting these costs was a pre-tax gain of \$0.3 million (US\$0.3 million) in March 2006 from EHSI’s sale of 50,000 of 100,000 shares it held of Omnicare, Inc. for proceeds of \$3.5 million (US\$3.1 million) and gains on sale of miscellaneous assets of \$0.2 million.

## Extendicare REIT – Notes to the Unaudited Consolidated Financial Statements

### 5. Discontinued Operations

The following is a summary of discontinued operations with prior periods revised for operations identified as discontinued in the first quarter of 2007.

	Three months ended June 30		Six months ended June 30	
<i>(thousands of dollars except per unit/share amounts)</i>	2007	2006	2007	2006
Revenue	634	67,889	3,389	138,300
Operating costs	2,630	47,212	6,340	97,408
Administrative costs	–	2,449	–	5,305
Lease costs	1	3,983	7	8,272
Earnings (loss) before undernoted	(1,997)	14,245	(2,958)	27,315
Depreciation and amortization	(1)	4,896	103	9,785
Accretion	16	25	37	53
Interest expense, net	(1)	1,570	(1)	3,302
Earnings (loss) before the undernoted	(2,011)	7,754	(3,097)	14,175
Gain (loss) from asset impairment, disposals and other items				
Impairment charges	–	(1,132)	(5,996)	(3,135)
Recoveries on sale of facilities and restructuring costs	170	(2,378)	321	(1,294)
	170	(3,510)	(5,675)	(4,429)
Earnings (loss) from discontinued operations before income taxes	(1,841)	4,244	(8,772)	9,746
Income tax expense (recovery)	(2,091)	4,226	(5,159)	6,509
Earnings (loss) from discontinued operations	250	18	(3,613)	3,237
<b>Earnings (Loss) per Unit/Subordinate Voting Share</b>				
Basic and diluted	–	–	(0.05)	0.05
<b>Earnings (Loss) per Multiple Voting Share</b>				
Basic and diluted				0.05

#### *Ohio Nursing Property*

In the 2007 first quarter, due to poor financial performance and regulatory issues of the facility, EHSI decided to close a nursing facility (175 beds) located in Dayton, Ohio and actively pursue the disposition of the property. As a result, EHSI has reclassified the financial results of this facility to discontinued operations and recorded an impairment charge of \$6.0 million (US\$5.1 million) to reduce the property to its fair value of \$0.3 million (US\$0.3 million). The facility was closed in May 2007.

#### *Texas and Washington Assisted Living Properties*

In the first quarter of 2007, EHSI sold a 60-unit assisted living facility located in San Antonio, Texas for proceeds of \$2.2 million (US\$1.9 million), resulting in a pre-tax recovery of \$0.2 million (US\$0.1 million). EHSI had previously closed and reclassified this operation to discontinued operations in the first quarter of 2006 due to poor financial performance and future capital needs. In the 2006 first quarter, EHSI recorded an impairment charge of \$2.0 million (US\$1.7 million) to reduce the property value to \$2.0 million (US\$1.8 million).

In addition, during the 2006 first quarter, the lease term for an assisted living facility located in Edmonds, Washington (63 units) ended and EHSI decided to terminate its operations due to poor financial performance. EHSI continued to operate the facility until September 2006 in order to assist the landlord in seeking an alternative operator or buyer of the property. As a result, the financial results of this facility were reclassified to discontinued operations. There was no gain or loss on disposition of the operations and leasehold interest.

#### *ALC Operations*

ALC was distributed to the Extendicare shareholders on November 10, 2006 as part of a plan of arrangement (the “Arrangement”) and the results of ALC have been reclassified as discontinued operations. For the six months ended June 30, 2006, \$2.6 million in restructuring costs were incurred, which were primarily professional fees for advisory, legal and audit services.

## Extencicare REIT – Notes to the Unaudited Consolidated Financial Statements

### Minnesota Nursing Properties

One of three Minnesota nursing properties classified as discontinued operations at the end of December 2005, was sold in the first quarter of 2006 for cash proceeds of \$1.4 million (US\$1.2 million), resulting in a pre-tax recovery of \$1.1 million (US\$0.9 million). In April 2006 an additional property was sold for \$0.5 million (US\$0.5 million), which resulted in a pre-tax recovery of \$0.2 million (US\$0.2 million).

### Wisconsin Nursing Facilities

In the second quarter of 2006, due to poor financial performance and future capital needs of a nursing facility (63 beds), EHSI decided to dispose of the facility, or close and actively pursue the disposition of this property, located in Milwaukee, Wisconsin. EHSI recorded an impairment charge of \$1.1 million (US\$1.0 million) to reduce the property value to \$0.3 million (US\$0.2 million), based upon its valuation of the property.

In December 2005 EHSI sold its Lakeside nursing facility, located in Chippewa Falls, Wisconsin. The facility, which was formerly leased to an operator, was classified as a discontinued operation. In the first quarter of 2006, EHSI incurred a general liability punitive settlement of \$1.6 million (US\$1.4 million) pertaining to the period that EHSI operated the facility, which was classified as an operating cost in discontinued operations.

## 6. Other Assets

<i>(thousands of dollars)</i>	<b>June 30 2007</b>	<b>December 31 2006</b>
Investments held for self-insured liabilities		
Held-to-maturity securities, at amortized cost <i>(note 2)</i>	<b>6,194</b>	–
Available-for-sale securities, at fair value <i>(note 2)</i>	<b>35,102</b>	–
Investments, at amortized cost <i>(note 2)</i>	–	54,705
Notes and mortgages receivable	<b>60,092</b>	57,122
Other long-term receivables	<b>6,565</b>	7,180
Deferred charges <i>(note 2)</i>	<b>6,885</b>	21,003
Assets held for sale	<b>7,465</b>	9,439
	<b>122,303</b>	149,449

The investments held for self-insured liabilities have been classified in accordance with Extencicare's adoption of the new accounting policy on January 1, 2007 for Financial Instruments – Recognition and Measurement as noted in *note 2*. Also, under this new accounting policy, deferred financing costs are classified as part of the carrying value of long-term debt and prior periods are not restated. Total deferred financing costs included in deferred charges of other assets at December 31, 2006, was \$18.6 million.

## 7. Goodwill and Other Intangible Assets

As a result of the nursing facility acquisition in the 2007 first quarter, goodwill increased by \$2.2 million (US\$1.9 million). As at June 30, 2007, intangible assets had a gross carrying value of \$11.0 million and accumulative amortization of \$10.9 million, for a net book value of \$0.1 million. The aggregate amortization expense for each of the six-month periods ended June 30, 2007 and 2006 was \$0.3 million and \$1.7 million, respectively.

## 8. Equity Accounted Investments

Extencicare's reported share of Crown Life's earnings for each of the six-month periods ended June 30, 2007 and 2006 was \$1.5 million and \$2.7 million, respectively. The 2007 amount was comprised of Extencicare's share of Crown Life's earnings of \$7.1 million offset by \$5.6 million to reflect the expected value of the proceeds from the sale of Extencicare's investment in Crown Life. In order for Crown Life to make a cash dividend payment to its shareholders on June 29, 2007, Crown Life liquidated a number of its investments, which resulted in a realization of gains that had been accumulated in other comprehensive income. However, the realization of these gains had already been considered by Extencicare when estimating the final settlement amounts in prior periods.

In 1998 an agreement was made to sell or indemnity reinsure substantially all of Crown Life's insurance business to The Canada Life Assurance Company (Canada Life). The resulting comprehensive agreements provided for the closing of the sale of a significant portion of Crown Life's business effective January 1, 1999. The agreements between Canada Life and Crown Life and its principal shareholders, HARO Financial Company (HARO) and Extencicare, also provided that at any time after January 1, 2004, Canada Life may either acquire substantially all of the balance of Crown Life's

## Extencicare REIT – Notes to the Unaudited Consolidated Financial Statements

insurance business or, at the election of Canada Life or Crown Life’s principal shareholders, make an offer for all of the common shares of Crown Life (the “second closing”). On April 24, 2006, the shareholders of Crown Life filed notice with Canada Life to initiate the second closing.

On June 8, 2007, the second closing agreement was executed. On June 29, 2007, pursuant to this agreement, Extencicare received a dividend of \$45.2 million from Crown Life consisting of \$26.6 million in cash and \$18.6 million in securities. Extencicare also completed a purchase and sale with HARO of certain securities received by it and HARO on the Crown Life dividend. As a result of these transactions, Extencicare received cash of \$15.1 million and was left with securities of \$3.6 million. Proceeds, net of costs, of \$41.6 million have been reported as a return of equity on the statement of cash flows. There were no dividends paid by Crown Life in 2006.

On July 5, 2007, Extencicare completed the sale of its investment in Crown Life, receiving a cash payment of \$40.0 million for its Crown Life shares from Canada Life. The proceeds are subject to a post closing adjustment to take into account the earnings of Crown Life from March 31, 2006 to the closing date, compared to the estimated earnings used for purposes of the closing and certain negotiated balance sheet amounts used for purposes of the closing, and the actual amounts to be determined within 75 days after closing including the differences in values of investments which are not allocated to policy liabilities, accrued interest on certain investments and certain insurance liabilities.

Under the Crown Life share sale agreement with Canada Life, Extencicare remains responsible for certain possible specified contingent claims against Crown Life of up to approximately \$18.8 million and in support of the claims, has delivered letters of credit to Crown Life in such amount drawn under its revolving line of credit with Royal Bank of Canada (the “RBC Credit Facility”) (note 9). Depending on the type of contingent claim, the letters of credit have various terms ranging from 5 to 15 years. Management estimates that Extencicare’s aggregate liability for such claims will not exceed \$6.0 million.

### 9. Long-term Debt

<i>(thousands of dollars)</i>	<b>June 30 2007</b>	<b>December 31 2006</b>
	<i>US\$</i>	<i>US\$</i>
<b>EHSI (payable in US\$)</b>		
CMBS at 6.6525% due 2011	500,000	582,700
Financing costs	(10,837)	
CMBS at 6.79%, due 2012	90,000	–
Financing costs	(2,476)	
Mortgages and Industrial Development Revenue Bonds, 7.25% to 13.61%, due 2007	2,856	3,462
Notes payable, 0% to 8%, maturing through to 2009	2,757	4,684
Financing costs on Credit Facility	(2,716)	
	<b>579,584</b>	<b>590,846</b>
<b>Extencicare REIT and Canadian Subsidiaries (payable in C\$)</b>		
Convertible Unsecured Subordinated Debentures, 5.7%, due 2014	<b>106,356</b>	–
Financing costs	(5,223)	
Mortgages, 4.63% to 9.81%, maturing through to 2017	<b>152,713</b>	129,057
Financing costs	(1,315)	
Obligations under capital leases, 7.28% to 8%, maturing through to 2028	<b>129,951</b>	131,277
Financing costs	(684)	
	<b>381,798</b>	260,334
	<b>999,287</b>	851,180
Less due within one year and included in current liabilities	<b>13,536</b>	13,423
	<b>985,751</b>	837,757

## Extendicare REIT – Notes to the Unaudited Consolidated Financial Statements

### *Canada Mortgage and Housing Corporation (CMHC) Financing for Canadian Properties*

On January 19, 2007, ECI completed \$26.3 million of CMHC mortgage financing secured by three of its Canadian nursing facilities. The three loans have 10-year terms with weighted average monthly payments amortized over 20-years at 4.67%.

### *Second Series of Commercial Mortgage Backed Securitization (CMBS) Financing*

EHSI completed on March 6, 2007, a second series of CMBS mortgages for US\$90.0 million due in 2012 with a fixed interest rate of 6.79%. The mortgages stipulate monthly payments of interest only for the first three years, and thereafter monthly payments of principal and interest based upon a 25-year amortization period. The CMBS mortgages are collateralized by first mortgages on 14 of EHSI's skilled nursing facilities. EHSI is required to maintain: (1) a consolidated leverage ratio (exclusive of any notes owing to Extendicare REIT and its subsidiaries) of less than 5.5 to 1.0; and (2) a consolidated fixed charge ratio of at least 1.5 to 1.0. The proceeds from the CMBS financing were used to pay income taxes due in March 2007 of \$120.2 million (US\$102.2 million) associated with the sale of ALC.

### *Convertible Subordinated Unsecured Debentures*

On June 21, 2007, the REIT completed a public offering of \$115.0 million of 5.70% convertible subordinated unsecured debentures, with a \$19.90 conversion price, due June 30, 2014 (the "2014 Debentures"). Interest is payable semi-annually. The net proceeds from the 2014 Debentures were \$109.3 million, after the payment of issue related costs of \$5.7 million, of which \$49.4 million (US\$46.0 million) was used to repay the balance outstanding under EHSI's revolving line of credit. The balance of the net proceeds will be used to fund future strategic acquisitions, internal growth expenditures, and for other general business purposes. As the 2014 Debentures are convertible into units of the REIT (the "REIT Units"), they are accounted for, in part, as equity. Extendicare REIT determined the fair value of the 2014 Debentures based on the present value of the future cash flows discounted using an effective interest rate of approximately 7.1%. The residual amount of the gross proceeds was allocated to the equity classified conversion option. The REIT has recorded a liability of \$106.3 million and equity of \$8.7 million on the \$115.0 million face value of the debentures. The liability portion is accreted up to the face value of the debentures during the term of the debentures. The issue related costs of \$5.7 million have been allocated on a pro rata basis and were recorded as a \$0.4 million reduction to the equity component and a \$5.3 million reduction to the liability. The \$5.3 million will be amortized to interest expense using the effective interest rate method over the term of the debentures.

### *Deferred Financing Costs*

Deferred financing costs included as part of long-term debt at June 30, 2007 were \$24.3 million. The deferred financing costs are valued at amortized cost using the effective interest rate method. Deferred financing costs of \$18.6 million were included in other assets at December 31, 2006 prior to the adoption of CICA Handbook Section 3855. Deferred financing costs increased \$9.5 million in the first half of 2007 associated with new debt financing, offset by \$2.2 million amortized to interest expense and a \$1.6 million decrease due to foreign exchange.

### *Other*

On June 29, 2007, Extendicare amended its RBC Credit Facility to increase its availability from \$50.0 million to \$70.0 million. The RBC Credit Facility is due on demand, is secured by 14 Canadian nursing homes, and is guaranteed by certain Canadian operating subsidiaries of Extendicare. It is primarily used to back letters of credit, of which there were \$45.1 million issued and outstanding as at June 30, 2007, to secure Extendicare's pension obligations. On July 5, 2007, the additional availability obtained was used to secure \$18.8 million of letters of credit in connection with the sale of Extendicare's investment in Crown Life Insurance Company.

## Extencicare REIT – Notes to the Unaudited Consolidated Financial Statements

### 10. Derivative Financial Instruments and Foreign Exchange Gains

For the six months ended June 30, 2007, Extencicare REIT recorded a foreign exchange gain of \$5.5 million resulting from the settlement of US dollar denominated notes between EHSI and some of the REIT's Canadian-based subsidiaries.

In addition, for the six months ended June 30, 2007, the revaluation of EHSI's foreign currency forward contracts resulted in an unrealized gain of \$11.6 million. One of the contracts locks in EHSI's exchange rate to acquire Canadian dollars at the fixed exchange rate of 1.1141 for US\$4.0 million per month for a 36-month term that commenced in December 2006 and ends in November 2009. In June 2007, EHSI entered into an additional foreign currency forward contract to cover the 7-month period from December 2009 to June 2010. This contract provides for a range of exchange rates on acquiring Canadian dollars for US\$4.0 million each month, with the floor rate set at 1.00 and the ceiling rate set at 1.1050, and the current exchange rate is applied if it falls between these two rates.

For the six months ended June 30, 2006, the valuation of EHSI's two interest rate cap agreements, which were terminated in October 2006, resulted in a gain of \$0.5 million.

### 11. Unit/Share Capital

#### *Authorized*

An unlimited number of REIT Units

An unlimited number of Exchangeable LP Units

Extencicare REIT may issue an unlimited number of trust units, or REIT Units. Each REIT Unit is transferable and represents an equal, undivided beneficial interest in the assets of the REIT. Each REIT Unit entitles the holder to one vote at all meetings of unitholders of the REIT. Holders of REIT Units are entitled to receive non-cumulative distributions from the REIT (whether of net income, net realized capital gains or other amounts) if, as and when declared by the Trustees. REIT Units are redeemable upon demand by the Unitholders, and may be purchased by the REIT for cancellation through offers made to, and accepted by, such holders. Otherwise, the REIT Units have no conversion, retraction, redemption or pre-emptive rights.

The Class B limited partnership units (the "Exchangeable LP Units") issued by Extencicare Limited Partnership are intended, to the greatest extent practicable, to be economically equivalent to REIT Units. Additionally, Exchangeable LP Units are accompanied by special voting units of the REIT that entitle the holder to receive notice of, attend and vote at all meetings of unitholders of the REIT. As a result, they have been treated for accounting purposes as REIT Unit equivalents. They are exchangeable on a one-for-one basis for REIT Units at the option of the holder, and will be automatically exchanged for REIT Units on November 10, 2011. Each Exchangeable LP Unit entitles the holder to receive distributions from Extencicare Limited Partnership that are, to the greatest extent practicable, economically equivalent to the distributions made to holders of REIT Units.

During the 2007 first half, 1,480,807 Exchangeable LP Units were exchanged for 1,480,807 REIT Units at the option of the holders.

#### *Distribution Reinvestment Plan*

The REIT has implemented a Distribution Reinvestment Plan (DRIP) pursuant to which holders of REIT Units and holders of Exchangeable LP Units who are residents in Canada may elect to reinvest their cash distributions in additional REIT Units or Exchangeable LP Units, as the case may be, on the date of the distribution, at a price equal to 97% of the volume weighted average trading price of the REIT Units on the Toronto Stock Exchange for the five trading days immediately preceding the corresponding date of distribution. During the 2007 first half, the REIT issued 139,579 REIT Units at a value of \$2.3 million, and Extencicare Limited Partnership issued 10,217 Exchangeable LP Units at a value of \$0.2 million in connection with the DRIP.

## Extencicare REIT – Notes to the Unaudited Consolidated Financial Statements

### *Other*

Prior to the Arrangement, during the first half of 2006, Extencicare purchased 13,000 Multiple Voting Shares at a cost of \$0.2 million and also purchased 4,500 Class I Preferred Shares, Series 2 at a cost of \$0.1 million pursuant to the purchase obligation provision. During the first half of 2006, Extencicare issued 159,125 Subordinate Voting Shares on exercise of stock options for proceeds of \$0.7 million, which after adjusting for tax credits and contributed surplus, increased capital stock by \$0.8 million. As a result of these transactions, the carrying value of capital stock increased by \$0.7 million and retained earnings was charged with \$0.2 million attributable to the cost of purchases in excess of their carrying value.

Prior to the Arrangement, for awards under Extencicare's Amended and Restated Subordinate Voting Share Option and Tandem SAR Plan (the "Stock Option Plan"), Extencicare accrued compensation expense on a graded vesting basis in the amount by which the quoted market value of the Subordinate Voting Shares exceeded the option price. Changes, in the quoted market value of the Subordinate Voting Shares between the date of grant and the reporting period date result in a change in the measure of compensation for the award. During the six months ended June 30, 2006, Extencicare accrued \$3.5 million of compensation expense associated with tandem SARs granted.

### **12. Earnings per Unit/Share**

Basic earnings per unit is calculated using the weighted average number of units outstanding during the period. Prior to the Arrangement, the calculation of earnings per share was based on net earnings reduced by dividends on preferred shares and reflected the quarterly preferential dividend of \$0.025 per share paid to holders of Subordinate Voting Shares. Net earnings remaining after these items were allocated equally to the Subordinate Voting Shares and Multiple Voting Shares.

Diluted earnings per unit/share, using the "if-converted" method and to the extent the conversion is dilutive, assumes all convertible securities have been converted at the beginning of the period, or at the time of issuance, if later, and any charges or returns on the convertible securities, on an after-tax basis, are removed from net earnings. In 2007 the after-tax interest on convertible debt has been removed from net earnings and the weighted average number of units has been increased by the number of units which would be issued on conversion of the convertible debt, pro-rated for the number of days in the period the convertible debt was outstanding.

Diluted earnings per unit/share, using the treasury stock method, assumes outstanding stock options are exercised at the beginning of the year and REIT units/common shares are purchased at the average market price during the period from the funds derived on the exercise of these outstanding options. Stock options, when applicable in 2006, with a strike price above the average market price for the period were excluded from the calculation of diluted earnings per unit/share as to include them would have increased earnings per unit/share.

## Extencicare REIT – Notes to the Unaudited Consolidated Financial Statements

The following table reconciles the numerator and denominator of the basic and diluted earnings (loss) per unit/share computation.

	Three months ended June 30		Six months ended June 30	
<i>(thousands of dollars unless otherwise noted)</i>	2007	2006	2007	2006
<b>Numerator for Basic and Diluted Earnings (Loss) per Unit/Share</b>				
<i>Net earnings (loss)</i>	28,309	(2,358)	43,675	11,360
Dividends on preferred shares	–	(208)	–	(401)
Net earnings (loss) after preferred share dividends	28,309	(2,566)	43,675	10,959
Subordinate Voting Share preferential dividend	–	(1,404)	–	(2,805)
Total for basic earnings (loss) per unit/share	28,309	(3,970)	43,675	8,154
After-tax interest on convertible debt	150	–	150	–
Dilutive Subordinate Voting Share preferential dividend	–	(24)	–	(46)
Total for diluted earnings (loss) per unit/share	28,459	(3,994)	43,825	8,108
<i>Earnings (loss) from continuing operations</i>				
Total of net earnings (loss) for basic earnings (loss) per unit/share	28,309	(3,970)	43,675	8,154
Loss (earnings) from discontinued operations, net of tax	(250)	(18)	3,613	(3,237)
Total from continuing operations for basic earnings (loss) per unit/share	28,059	(3,988)	47,288	4,917
After-tax interest on convertible debt	150	–	150	–
Dilutive Subordinate Voting Share preferential dividend	–	(24)	–	(46)
Total from continuing operations for diluted earnings (loss) per unit/share	28,209	(4,012)	47,438	4,871
<b>Denominator for Basic and Diluted Earnings (Loss) per Unit/Share (thousands)</b>				
Weighted average number of units/shares:				
Units	70,324	–	70,279	–
Subordinate Voting Shares	–	56,153	–	56,108
Multiple Voting Shares	–	11,779	–	11,780
Total for basic earnings (loss) per unit/share	70,324	67,932	70,279	67,888
Units issued if all convertible debt was converted <sup>(1)</sup>	572	–	289	–
Dilutive Subordinate Voting Share stock options <sup>(2)</sup>	–	944	–	912
Total for diluted earnings (loss) per unit/share	70,896	68,876	70,568	68,800
<b>Basic and Diluted Earnings (Loss) per Unit/Share (dollars) <sup>(3)</sup></b>				
REIT/Exchangeable LP, Subordinate Voting	0.40	(0.03)	0.62	0.17
Multiple Voting	–	(0.06)	–	0.12
<b>Basic and Diluted Earnings (Loss) from Continuing Operations per Unit/Share (dollars) <sup>(2)</sup></b>				
REIT/Exchangeable LP, Subordinate Voting	0.40	(0.03)	0.67	0.12
Multiple Voting	–	(0.06)	–	0.07

<sup>(1)</sup> Pro-rated for the 9 days in the six months ended June 30, 2007 the convertible debt was outstanding.

<sup>(2)</sup> For the six months ended June 30, 2006, there were no stock options excluded from the calculation of dilutive stock options.

<sup>(3)</sup> After giving effect to the Subordinate Voting Share preferential dividend of \$0.050 per share in the six months ended June 30, 2006.

**13. Commitments and Contingencies**

*Acquisitions*

On May 9, 2007, EHSI entered into a purchase and sale agreement with the shareholders of Tendercare (Michigan) Inc. and affiliated entities (collectively “Tendercare”), a private nursing home operator in the state of Michigan. Total consideration for the transaction including assumption of debt is expected to be approximately US\$202.5 million, prior to working capital and two projects under development. The transaction is structured to be payable with cash of US\$122.5 million plus the assumption of US\$80 million of debt.

The Tendercare portfolio is comprised of 31 senior care facilities, composed of 29 skilled nursing facilities, one assisted living facility and one rehab hospital representing 3,400 operational beds. As well, Tendercare currently has two skilled nursing facilities under development that will also be acquired by EHSI at cost upon completion.

The completion of the acquisition is subject to certain customary regulatory approvals, including approval by the U.S. Department of Housing and Urban Development. Extendicare REIT is working towards closing the transaction by the end of 2007. Management will determine the optimum financing of the acquisition prior to closing.

In May 2007, EHSI entered into an agreement to purchase an assisted living facility (56 units) in Wisconsin for US\$5.5 million in cash. The transaction closed on August 1, 2007.

In July 2007, EHSI entered into an agreement to purchase a skilled nursing facility (99 beds) in Milwaukee, Wisconsin for cash consideration of US\$7.5 million. EHSI expects to close the transaction in the fourth quarter of 2007.

*Property and Equipment Commitments*

At June 30, 2007, outstanding capital expenditure commitments for EHSI totalled \$21.3 million (US\$20.0 million). Included in EHSI’s outstanding commitments was US\$6.5 million related to two expansion projects estimated to cost approximately US\$13.1 million, of which US\$5.5 million was spent through June 30, 2007.

*Contingent Liabilities*

The REIT and its consolidated subsidiaries are defendants in actions brought against them from time to time in connection with their operations. It is not possible to predict the ultimate outcome of the various proceedings at this time or to estimate additional costs that may result.

## Extendicare REIT – Notes to the Unaudited Consolidated Financial Statements

### 14. Segmented Information

	Three months ended		Six months ended	
	June 30		June 30	
<i>(millions of dollars)</i>	2007	2006	2007	2006
<b>Revenue</b>				
United States	302.5	288.7	622.2	579.6
Canada	141.4	136.5	278.5	267.1
	443.9	425.2	900.8 <sup>(2)</sup>	846.7
<b>EBITDA</b> <sup>(1)</sup>				
United States	39.6	36.1	81.4	70.1
Canada	14.4	12.3	25.2	20.1
	54.0	48.4	106.7 <sup>(2)</sup>	90.2
<b>Earnings (Loss) from Continuing Health Care Operations</b>				
United States	19.1	(6.0)	35.0	3.9
Canada	8.0	2.0	10.8	1.8
	27.1	(4.0)	45.7 <sup>(2)</sup>	5.7

	June 30	Dec. 31
	2007	2006
<i>(millions of dollars)</i>		
<b>Goodwill</b>		
United States <sup>(3)</sup>	75.4	80.3
<b>Health Care Assets</b>		
United States	885.7	894.9
Canada	410.7	342.5
	1,296.4	1,237.4
<b>Equity accounted investments</b>	35.0	77.8
<b>Total consolidated assets</b>	1,331.4	1,315.2

<sup>(1)</sup> EBITDA refers to earnings before interest, taxes, depreciation, amortization, accretion, loss (gain) on derivative financial instruments and foreign exchange, and loss (gain) from restructuring charges, asset disposals and other items.

<sup>(2)</sup> Does not add due to rounding.

<sup>(3)</sup> The change in goodwill is due to \$2.2 million pertaining to acquisitions in the first six months, partly offset by \$7.1 million for foreign currency translation of U.S. operations.

### 15. Employee Future Benefits

The future benefit expense of Extendicare's defined benefit pension plans for each of the three-month periods ended June 30, 2007 and 2006 was \$0.5 million and \$0.9 million, respectively. For each of the six months ended June 30, 2007 and 2006, the future benefit expense was \$1.1 million and \$1.9 million, respectively.

# EXTENDICARE

<b>Facility Location and Resident Capacity</b>								
<i>at June 30, 2007</i>	<b>Nursing Centres</b>		<b>Assisted Living and Retirement Centres</b>		<b>Chronic Care Units</b>		<b>Total</b>	
<b>By State/Province</b>	<b>Number of Facilities</b>	<b>Resident Capacity</b>	<b>Number of Facilities</b>	<b>Resident Capacity</b>	<b>Number of Facilities</b>	<b>Resident Capacity</b>	<b>Number of Facilities</b>	<b>Resident Capacity</b>
<b>United States</b>								
Pennsylvania	28	3,438	6	247	–	–	34	3,685
Ohio	28	2,861	–	30	–	–	28	2,891
Wisconsin	24	2,151	–	17	–	–	24	2,168
Indiana	19	1,866	–	35	–	–	19	1,901
Kentucky	21	1,822	–	–	–	–	21	1,822
Washington	15	1,618	1	47	–	–	16	1,665
Minnesota	8	1,039	–	–	–	–	8	1,039
Idaho	2	194	–	–	–	–	2	194
Oregon	2	169	–	–	–	–	2	169
Delaware	1	120	–	–	–	–	1	120
West Virginia	1	120	–	–	–	–	1	120
<b>Total United States</b>	<b>149</b>	<b>15,398</b>	<b>7</b>	<b>376</b>	<b>–</b>	<b>–</b>	<b>156</b>	<b>15,774</b>
<b>Canada</b>								
Ontario	53	7,911	1	493	1	120	55	8,524
Alberta	13	1,137	–	–	–	–	13	1,137
Saskatchewan	5	654	–	–	–	–	5	654
Manitoba	5	762	–	–	–	–	5	762
<b>Total Canada</b>	<b>76</b>	<b>10,464</b>	<b>1</b>	<b>493</b>	<b>1</b>	<b>120</b>	<b>78</b>	<b>11,077</b>
<b>TOTAL</b>	<b>225</b>	<b>25,862</b>	<b>8</b>	<b>869</b>	<b>1</b>	<b>120</b>	<b>234</b>	<b>26,851</b>
<b>By Type of Ownership</b>								
<b>United States</b>								
Owned	135	13,821	2	221	–	–	137	14,042
Leased	7	764	–	–	–	–	7	764
Managed	7	813	5	155	–	–	12	968
<b>Total United States</b>	<b>149</b>	<b>15,398</b>	<b>7</b>	<b>376</b>	<b>–</b>	<b>–</b>	<b>156</b>	<b>15,774</b>
<b>Canada</b>								
Owned	45	6,083	–	–	–	–	45	6,083
Leased	9	1,155	–	76	–	–	9	1,231
Managed	22	3,226	1	417	1	120	24	3,763
<b>Total Canada</b>	<b>76</b>	<b>10,464</b>	<b>1</b>	<b>493</b>	<b>1</b>	<b>120</b>	<b>78</b>	<b>11,077</b>
<b>TOTAL</b>	<b>225</b>	<b>25,862</b>	<b>8</b>	<b>869</b>	<b>1</b>	<b>120</b>	<b>234</b>	<b>26,851</b>

## Unitholder Information

### Stock Exchange Listing

Toronto Stock Exchange – EXE.UN

### Transfer Agent

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### Unitholder Inquiries/Investor Relations

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### Published Information

Extendicare REIT's 2006 Annual Report is available for viewing or printing on its website, in addition to news releases, quarterly reports and other filings with the securities commissions.

Printed copies are available upon request to the Secretary.

Visit Extendicare's website @ [www.extendicare.com](http://www.extendicare.com)

