

Interim Condensed Consolidated Financial Statements of

**MEDICAL FACILITIES
CORPORATION**

For the three and nine months ended September 30, 2017
(Unaudited)
(In U.S. dollars)

TABLE OF CONTENTS

FINANCIAL STATEMENTS

	Page
Interim Condensed Consolidated Balance Sheets	3
Interim Condensed Consolidated Statements of Changes in Equity	4
Interim Condensed Consolidated Statements of Income and Comprehensive Income.....	5
Interim Condensed Consolidated Statements of Cash Flows	6

NOTES TO THE FINANCIAL STATEMENTS

	Page
1. Reporting entity	7
2. Statement of compliance	7
3. Basis of preparation.....	8
4. Acquisition of Unity Medical and Surgical Hospital	8
5. Earnings (loss) per share	9
6. Normal course issuer bids for common shares	12
7. Net changes in non-cash working capital.....	12
8. Financial instruments.....	12
9. Income taxes	15
10. Interest expense, net of interest income from continuing operations.....	15
11. Related party transactions and balances	15
12. Commitments and contingencies	16
13. CEO transition	17
14. Share based compensation.....	17
15. Significant accounting policies	18

MEDICAL FACILITIES CORPORATION

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

	Note	September 30, 2017 \$	December 31, 2016 \$
ASSETS			
Current assets			
Cash and cash equivalents		52,087	51,014
Restricted cash		-	6,437
Short-term investments		11,035	8,569
Accounts receivable		49,123	61,058
Supply inventory		6,611	6,252
Prepaid expenses and other		6,850	6,011
Income tax receivable		3,764	-
Total current assets		129,470	139,341
Non-current assets			
Long-term investments		-	1,613
Deferred income tax assets		9,622	15,712
Property and equipment		95,831	94,893
Goodwill		133,581	136,920
Other intangibles		90,294	102,427
Other assets	11.1	1,609	1,555
Total non-current assets		330,937	353,120
TOTAL ASSETS		460,407	492,461
LIABILITIES AND EQUITY			
Current liabilities			
Interest payable		494	-
Dividends payable		2,328	2,168
Accounts payable		18,979	21,609
Accrued liabilities		18,297	20,572
Income tax payable		-	202
Current portion of long-term debt		13,933	20,818
Total current liabilities		54,031	65,369
Non-current liabilities			
Corporate credit facility		47,750	47,750
Long-term debt		52,588	56,094
Convertible debentures		34,117	32,102
Exchangeable interest liability	8.2	73,350	77,034
Deferred income tax liability		1,279	-
Total non-current liabilities		209,084	212,980
Total liabilities		263,115	278,349
Equity			
Share capital		396,428	397,522
Contributed surplus		449	181
Deficit		(259,020)	(248,994)
Equity attributable to owners of the Corporation		137,857	148,709
Non-controlling interest		59,435	65,403
Total equity		197,292	214,112
TOTAL LIABILITIES AND EQUITY		460,407	492,461

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

MEDICAL FACILITIES CORPORATION

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

	Note	Attributable to Owners of the Corporation			Non-controlling Interest	Total Equity	
		Share Capital \$	Contributed Surplus \$	Deficit \$	Total \$	\$	\$
2017							
Balance at January 1, 2017		397,522	181	(248,994)	148,709	65,403	214,112
Net income and comprehensive income for the period		-	-	10,092	10,092	18,936	29,028
Dividends to owners of the Corporation		-	-	(20,118)	(20,118)	-	(20,118)
Distributions to non-controlling interest		-	-	-	-	(24,904)	(24,904)
Share based compensation	14	-	268	-	268	-	268
Purchase of common shares under normal course issuer bids	6	(1,094)	-	-	(1,094)	-	(1,094)
Balance at September 30, 2017		396,428	449	(259,020)	137,857	59,435	197,292
2016							
Balance at January 1, 2016		398,166	-	(232,312)	165,854	48,828	214,682
Net income (loss) and comprehensive income (loss) for the period		-	-	(18,356)	(18,356)	19,340	984
Share based compensation	14	-	92	-	92	-	92
Dividends to owners of the Corporation		-	-	(19,929)	(19,929)	-	(19,929)
Distributions to non-controlling interest		-	-	-	-	(23,568)	(23,568)
Acquisition of Unity Medical and Surgical Hospital		-	-	-	-	10,732	10,732
Acquisition of Integrated Medical Delivery, L.L.C.		-	-	-	-	1,681	1,681
Purchase of common shares under normal course issuer bids	6	(644)	-	-	(644)	-	(644)
Balance at September 30, 2016		397,522	92	(270,597)	127,017	57,013	184,030

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

MEDICAL FACILITIES CORPORATION

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

	Note	Three Months Ended September 30,		Nine Months Ended September 30,	
		2017 \$	2016 \$	2017 \$	2016 \$
Facility service revenue		88,974	78,806	274,063	231,479
Operating expenses					
Salaries and benefits		26,418	22,787	78,776	67,825
Drugs and supplies		26,942	23,250	82,373	68,013
General and administrative expenses		16,266	13,147	50,346	37,200
Depreciation of property and equipment		2,816	2,253	8,490	6,450
Amortization of other intangibles		4,100	3,187	12,133	9,220
		76,542	64,624	232,118	188,708
Income from operations		12,432	14,182	41,945	42,771
Finance costs					
Increase in value of convertible debentures		1,307	2,381	2,015	5,984
Increase (decrease) in value of exchangeable interest liability		8,017	10,856	(3,684)	37,060
Interest expense on exchangeable interest liability		2,121	1,823	6,724	6,435
Interest expense, net of interest income	10	1,612	1,079	4,680	2,512
Loss (gain) on foreign currency		(393)	150	(828)	(620)
		12,664	16,289	8,907	51,371
Income (loss) before income taxes		(232)	(2,107)	33,038	(8,600)
Income tax expense (recovery)	9	(2,397)	(1,730)	4,010	(9,578)
Income (loss) for the period from continuing operations		2,165	(377)	29,028	978
Discontinued operation					
Income for the period from discontinued operation, net of tax		-	-	-	6
Net income and comprehensive income for the period		2,165	(377)	29,028	984
Attributable to:					
Owners of the Corporation		(3,560)	(6,836)	10,092	(18,356)
Non-controlling interest		5,725	6,459	18,936	19,340
		2,165	(377)	29,028	984
Earnings (loss) per share					
From continuing and discontinued operations					
Basic	5	\$ (0.11)	\$ (0.22)	\$ 0.33	\$ (0.59)
Fully diluted	5	\$ (0.11)	\$ (0.22)	\$ 0.33	\$ (0.59)
From continuing operations					
Basic	5	\$ (0.11)	\$ (0.22)	\$ 0.33	\$ (0.59)
Fully diluted	5	\$ (0.11)	\$ (0.22)	\$ 0.33	\$ (0.59)

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

MEDICAL FACILITIES CORPORATION

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

	Note	Nine Months Ended September 30,	
		2017 \$	2016 \$
Cash flows from operating activities			
Net income for the period		29,028	984
Adjustments for:			
Depreciation of property and equipment		8,490	6,450
Amortization of other intangibles		12,133	9,220
Share of equity income in associates		(86)	(103)
Change in value of convertible debentures		2,015	5,983
Change in value of exchangeable interest liability		(3,684)	37,060
Gain on foreign currency		(828)	(620)
Income tax expense (recovery)	9	4,010	(9,578)
Share based compensation	14	268	92
Interest expense, net of interest income		11,404	8,947
		62,750	58,435
Changes in non-cash operating working capital	7	8,171	9,462
		70,921	67,897
Interest paid, net of received		(10,911)	(8,479)
Income and withholding taxes paid		(605)	(1,219)
Net cash provided by operating activities		59,405	58,199
Cash flows from investing activities			
Purchase of property and equipment		(8,185)	(38,473)
Investment in RRIMH		(245)	-
Business combinations		-	(28,704)
Redemption (purchase) of short-term and long-term bank investments		(853)	2,583
Net cash used in investing activities		(9,283)	(64,594)
Cash flows from financing activities			
Proceeds (repayments) from revolving credit facilities and issuance/redemption of notes payable		(1,031)	7,293
Proceeds from revolving Corporate credit facility		-	47,750
Repayments of notes payable at the Facilities		(9,360)	(2,779)
Distributions, return of capital and loan receivable from an associate		33	78
Distributions to non-controlling interest		(24,904)	(23,568)
Dividends paid		(19,958)	(19,817)
Purchase of common shares under the terms of normal course issuer bids	6	(1,094)	(644)
Net cash used in (received from) financing activities		(56,314)	8,313
Increase (decrease) in cash and cash equivalents		(6,192)	1,918
Effect of exchange rate fluctuations on cash balances held		828	620
Cash and cash equivalents, beginning of the period (including restricted cash)		57,451	57,969
Cash and cash equivalents, end of the period		52,087	60,507

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

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

1. REPORTING ENTITY

Medical Facilities Corporation (the "Corporation") is a British Columbia corporation. The address of the Corporation's head office is 45 St. Clair Avenue West, Suite 200, Toronto, Ontario, Canada. The common shares of the Corporation are listed on the Toronto Stock Exchange under the ticker symbol "DR".

The Corporation's operations are based in the United States. Through its wholly-owned subsidiaries, the Corporation owns controlling interests in eight limited liability entities, six of which own a specialty hospital or an ambulatory surgery center (the "Facilities"). The Corporation also owns a 51% controlling interest in Integrated Medical Delivery, L.L.C., a diversified healthcare service company that provides third-party business solutions to healthcare entities. On October 3, 2016, Sioux Falls Specialty Hospital, LLP, one of the Corporation's Facilities, acquired 100% of Prairie States Surgical Center, L.L.C., and integrated it into its operations.

The Corporation's beneficial ownership interest in each of its operating subsidiaries is as follows:

Facilities	Location	Ownership Interest September 30,	
		2017	2016
Arkansas Surgical Hospital, L.L.C. ("ASH")	North Little Rock, Arkansas	51.0%	51.0%
Unity Medical and Surgical Hospital ("UMASH")	Mishawaka, Indiana	62.0%	62.0%
Oklahoma Spine Hospital, LLC ("OSH")	Oklahoma City, Oklahoma	60.3%	60.3%
Black Hills Surgical Hospital, LLP ("BHSH")	Rapid City, South Dakota	54.2%	54.2%
Sioux Falls Specialty Hospital, LLP ("SFSH")	Sioux Falls, South Dakota	51.0%	51.0%
The Surgery Center of Newport Coast, LLC ("SCNC")	Newport Beach, California	51.0%	51.0%
Other			
RRI Mishawaka Hospital, LP ("RRIMH")	Mishawaka, Indiana	92.0%	84.0%
Integrated Medical Delivery, L.L.C. ("IMD")	Oklahoma City, Oklahoma	51.0%	51.0%

2. STATEMENT OF COMPLIANCE

These unaudited interim condensed consolidated financial statements ("consolidated financial statements") have been prepared in accordance with International Accounting Standard IAS 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB") using the accounting policies as described in the annual financial statements as at December 31, 2016 and presented in note 15 to these consolidated financial statements.

These consolidated financial statements were approved for issue by the Corporation's Board of Directors on November 8, 2017.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

3. BASIS OF PREPARATION

These consolidated financial statements do not contain all of the disclosures that are required in annual financial statements prepared under International Financial Reporting Standards (“IFRS”) and should be read in conjunction with the Corporation’s audited consolidated financial statements for the year ended December 31, 2016, which include information necessary or useful to understand the Corporation’s business and financial statement presentation.

Income from operations for the interim period is not necessarily indicative of the results for the full year. Facility service revenue and certain directly related expenses are subject to seasonal fluctuations due to the timing of case scheduling, which can be impacted by the vacation schedules of surgeons, as well as the extent to which patients have remaining deductibles on their insurance coverage, based on the time of year. Occupancy related expenses, certain operating expenses, depreciation and amortization, and interest expense remain relatively steady throughout the year.

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

4. ACQUISITION OF UNITY MEDICAL AND SURGICAL HOSPITAL

Changes have been made to the final purchase price allocation versus the preliminary figures presented as at December 31, 2016, resulting in a decrease in goodwill from \$12,215 to \$8,876, a decrease in accrued liabilities and other liabilities from \$8,444 to \$6,105, and an increase in property and equipment from \$2,257 to \$3,257. The final purchase price allocation as at September 30, 2017 is as follows:

	September 30, 2017	December 31, 2016
	\$	\$
Cash	786	786
Accounts receivable	11,653	11,653
Prepaid expenses and other	1,023	1,023
Property and equipment	3,257	2,257
Goodwill	8,876	12,215
Other intangibles	44,500	44,500
Accounts payable	(3,358)	(3,358)
Accrued liabilities and other liabilities	(6,105)	(8,444)
Long-term debt	(15,870)	(15,870)
Non-controlling interest	(17,012)	(17,012)
Fair value of net assets acquired	27,750	27,750

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

5. EARNINGS (LOSS) PER SHARE

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

	Three Months Ended September 30,					
	2017			2016		
	Continuing Operations	Discontinued Operation	Total	Continuing Operations	Discontinued Operation	Total
Net loss for the period attributable to owners of the Corporation	\$ (3,560)	-	(3,560)	(6,836)	-	(6,836)
Divided by weighted average number of common shares outstanding for the period	30,974,315	30,974,315	30,974,315	31,045,945	31,045,945	31,045,945
Basic loss per share attributable to owners of the Corporation	\$ (0.11)	-	(0.11)	(0.22)	-	(0.22)

	Nine Months Ended September 30,					
	2017			2016		
	Continuing Operations	Discontinued Operation	Total	Continuing Operations	Discontinued Operation	Total
Net income (loss) for the period attributable to owners of the Corporation	\$ 10,092	-	10,092	(18,360)	4	(18,356)
Divided by weighted average number of common shares outstanding for the period	31,020,707	31,020,707	31,020,707	31,051,474	31,051,474	31,051,474
Basic earnings (loss) per share attributable to owners of the Corporation	\$ 0.33	-	0.33	(0.59)	-	(0.59)

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

5. EARNINGS (LOSS) PER SHARE (Continued)

	Three Months Ended September 30, 2017			Three Months Ended September 30, 2016		
	Continuing Operations	Discontinued Operation	Total	Continuing Operations	Discontinued Operation	Total
Net loss for the period attributable to owners of the Corporation	\$ (3,560)	-	(3,560)	(6,836)	-	(6,836)
Change in value of convertible debentures	-	-	-	-	-	-
Interest saved by converting debentures (tax effected)	-	-	-	-	-	-
Change in value of exchangeable interest liability (tax effected)	-	-	-	-	-	-
Interest expense on exchangeable interest liability (tax effected)	-	-	-	-	-	-
Incremental net income from increased ownership	-	-	-	-	-	-
Modified net loss for the period attributable to owners of the Corporation	\$ (3,560)	-	(3,560)	(6,836)	-	(6,836)
Divided by weighted average number of common shares:						
Outstanding for the period	30,974,315	-	30,974,315	31,045,945	-	31,045,945
Deemed to be issued on the conversion of the outstanding convertible debentures	-	-	-	-	-	-
Deemed to be issued on the exchange of the outstanding exchangeable interest liability	-	-	-	-	-	-
Deemed to be issued on the exercise of stock options	-	-	-	-	-	-
Weighted average number of common shares ⁽¹⁾	30,974,315	-	30,974,315	31,045,945	-	31,045,945
Fully diluted loss per share attributable to owners of the Corporation	\$ (0.11)	-	(0.11)	(0.22)	-	(0.22)

⁽¹⁾ For the three months ended September 30, 2017 and the three months ended September 30, 2016, the impact of convertible debentures, exchangeable interest liabilities, and stock options were excluded from the diluted weighted average number of ordinary shares calculation because their effect would have been anti-dilutive.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

5. EARNINGS (LOSS) PER SHARE (Continued)

	Nine Months Ended September 30, 2017			Nine Months Ended September 30, 2016		
	Continuing Operations	Discontinued Operation	Total	Continuing Operations	Discontinued Operation	Total
Net income (loss) for the period attributable to owners of the Corporation	\$ 10,092	-	10,092	(18,360)	4	(18,356)
Change in value of convertible debentures	-	-	-	-	-	-
Interest saved by converting debentures (tax effected)	-	-	-	-	-	-
Change in value of exchangeable interest liability (tax effected)	-	-	-	-	-	-
Interest expense on exchangeable interest liability (tax effected)	-	-	-	-	-	-
Incremental net income from increased ownership	-	-	-	-	-	-
Modified net income (loss) for the period attributable to owners of the Corporation	\$ 10,092	-	10,092	(18,360)	4	(18,356)
Divided by weighted average number of common shares:						
Outstanding for the period	31,020,707	-	31,020,707	31,051,474	-	31,051,474
Deemed to be issued on the conversion of the outstanding convertible debentures	-	-	-	-	-	-
Deemed to be issued on the exchange of the outstanding exchangeable interest liability	-	-	-	-	-	-
Deemed to be issued on the exercise of stock options	2,354	-	2,354	-	-	-
Weighted average number of common shares ⁽²⁾	31,023,061	-	31,023,061	31,051,474	-	31,051,474
Fully diluted earnings (loss) per share attributable to the owners of the Corporation	\$ 0.33	-	0.33	(0.59)	-	(0.59)

⁽²⁾ For the nine months ended September 30, 2017, the impact of convertible debentures and exchangeable interest liabilities was excluded from the diluted weighted average number of ordinary shares calculation because its effect would have been anti-dilutive. For the nine months ended September 30, 2016, the impact of convertible debentures, exchangeable interest liabilities, and stock options were excluded from the diluted weighted average number of ordinary shares calculation because their effect would have been anti-dilutive.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

6. NORMAL COURSE ISSUER BIDS FOR COMMON SHARES

The Corporation's current normal course issuer bid for up to 620,918 of its common shares is in effect from May 16, 2017 to May 15, 2018. During the three months ended September 30, 2017, the Corporation purchased 35,600 of its common shares for \$424. During the nine months ended September 30, 2017, the Corporation purchased 95,600 of its common shares for \$1,094. During the nine months ended September 30, 2016, the Corporation purchased 67,500 of its common shares for \$644 under a previous normal course issuer bid, with none of the purchases taking place in the three months ended September 30, 2016.

The purchases under the bids are recorded in share capital. All common shares acquired under these bids were cancelled.

7. NET CHANGES IN NON-CASH WORKING CAPITAL

The net changes in non-cash working capital included in the statement of cash flows consist of the following:

	Nine Months Ended September 30,	
	2017	2016
	\$	\$
Accounts receivable	11,935	10,357
Supply inventory	(359)	(622)
Prepaid expenses and other	(839)	(1,035)
Accounts payable	(2,630)	(5,135)
Accrued liabilities	64	5,897
Net changes in non-cash working capital	8,171	9,462

8. FINANCIAL INSTRUMENTS

8.1 Fair values and classification of financial instruments

The fair values of the convertible debentures and exchangeable interest liability are determined based on specific inputs including the closing trading price of the securities at each reporting period. The fair values of the corporate credit facility and long-term debt at the Facilities approximate their book values as the interest rates are similar to prevailing market rates. The fair values of all other financial instruments of the Corporation, due to the short-term nature of these instruments, approximate their book values.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

8. FINANCIAL INSTRUMENTS (Continued)

The following table presents the carrying values and classification of the Corporation's financial instruments as at September 30, 2017 and December 31, 2016:

	September 30, 2017	December 31, 2016
	\$	\$
Financial assets		
Fair value through profit or loss		
Cash and cash equivalents	52,087	51,014
Restricted cash	-	6,437
Held-to-maturity (carried at amortized cost)		
Short-term investments	11,035	8,569
Long-term investments	-	1,613
Loans and receivable (carried at amortized cost)		
Accounts receivable	49,123	61,058
Other assets	1,609	1,555
Financial liabilities		
Fair value through profit or loss		
Convertible debentures	34,117	32,102
Exchangeable interest liability	73,350	77,034
Other liabilities (carried at amortized cost)		
Interest payable	494	-
Dividends payable	2,328	2,168
Accounts payable	18,979	21,609
Accrued liabilities	18,297	20,572
Long-term debt and corporate credit facility	114,271	124,662

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

8. FINANCIAL INSTRUMENTS (Continued)

The financial instruments of the Corporation that are recorded at fair value have been classified into levels using a fair value hierarchy (note 15.17). The following tables represent the fair value hierarchy of the Corporation's financial instruments that were recognized at fair value as of September 30, 2017 and December 31, 2016. It does not include fair value information for financial instruments not measured at fair value for instruments that are short term in nature, carried at amortized cost.

	September 30, 2017			Total \$
	Level 1 \$	Level 2 \$	Level 3 \$	
Financial assets				
Cash and cash equivalents	52,087	-	-	52,087
Short-term investments	11,035	-	-	11,035
Financial liabilities				
Convertible debentures	34,117	-	-	34,117
Exchangeable interest liability	-	73,350	-	73,350
Total	97,239	73,350	-	170,589

	December 31, 2016			Total \$
	Level 1 \$	Level 2 \$	Level 3 \$	
Financial assets				
Cash and cash equivalents	51,014	-	-	51,014
Short-term investments	8,569	-	-	8,569
Long Term Investments	1,613	-	-	1,613
Financial liabilities				
Convertible debentures	32,102	-	-	32,102
Exchangeable interest liability	-	77,034	-	77,034
Total	93,298	77,034	-	170,332

8.2 Measurement of fair values

The following are the valuation techniques used in measuring Level 2 fair values (the Corporation does not have any Level 3 fair values).

Financial Instrument	Valuation Technique
Exchangeable interest liability	<i>Market comparison technique:</i> The number of the Corporation's common shares to issue is based on the contractual agreements with the holders of non-controlling interest that have exchange agreements with the Corporation and take into account the distributions to the non-controlling interest over the prior twelve months. The liability is valued based on the market price of the Corporation's common shares converted to the reporting currency as of the reporting date.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

9. INCOME TAXES

The Corporation's U.S. tax return is prepared on a consolidated basis for U.S. entities and includes balances and amounts attributable to these entities. The Corporation's Canadian income tax return is prepared on a stand-alone basis and includes non-consolidated balances attributable to the Canadian entity only. Income taxes from continuing operations reported in these consolidated financial statements are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017 \$	2016 \$	2017 \$	2016 \$
Provision for Income Taxes				
Current	(2,951)	44	(3,361)	(324)
Deferred	554	(1,774)	7,371	(9,254)
Total income tax expense (recovery) from continuing operations	(2,397)	(1,730)	4,010	(9,578)

10. INTEREST EXPENSE, NET OF INTEREST INCOME FROM CONTINUING OPERATIONS

Interest expense, net of interest income, from continuing operations included in the statement of income and comprehensive income consists of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017 \$	2016 \$	2017 \$	2016 \$
Interest expense at Facility level	569	346	1,723	1,376
Interest expense on convertible debentures	494	474	1,407	1,369
Interest expense at corporate level	602	226	1,707	226
Amortization of available credit facility stand-by fees	31	62	92	183
Interest income at Facility level	(4)	(6)	(14)	(14)
Interest income at corporate level	(80)	(23)	(235)	(628)
Interest expense, net of interest income, from continuing operations	1,612	1,079	4,680	2,512

11. RELATED PARTY TRANSACTIONS AND BALANCES

11.1 Equity accounted investments

The Corporation owns a 54.22% equity interest in Mountain Plains Real Estate Holdings, LLC ("MPREH"), an entity over which it has significant influence. The Corporation uses the equity method to account for this investment which is valued at \$693 as of September 30, 2017 (December 31, 2016: \$678).

The Corporation owns a 32.0% equity interest in South Dakota Interventional Pain Institute, LLC ("SDIPI"). The Corporation has significant influence over the associate because of its equity position and its representation on the board of the associate. The investment in and loan receivable from the associate as at September 30, 2017 were \$513 and \$62, respectively (December 31, 2016: \$455 and \$81, respectively).

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

11. RELATED PARTY TRANSACTIONS AND BALANCES (Continued)

The Corporation has a 0.35% ownership interest in an entity that holds an indirect interest in BSHS for a total investment of \$341 (December 31, 2016: \$341), for which the investment is accounted for at cost in the consolidated financial statements.

Together, the three investments comprise the 'Other assets' on the consolidated balance sheet.

11.2 Related party transactions

A member of the Corporation's Board of Directors is a minority owner of a Facility of the Corporation and a member of an ownership group that owns and leases hospital real estate to the Facility, for which the Facility paid rent for the three and nine months ended September 30, 2017 of \$1,125 and \$3,376, respectively. As well, the director is a member of another ownership group that owns and leases imaging equipment to the same Facility, for which the Facility paid equipment rental expense for the three and nine months ended September 30, 2017 of \$148 and \$445, respectively.

Certain Facilities routinely enter into transactions with related parties for provision of services relating to the use of facilities and equipment. These parties are considered related as the Corporation has significant influence over these entities. Such transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed by the related parties. For the three and nine months ended September 30, 2017, SFSH paid SDIPI \$165 and \$495, respectively, for the use of a facility and related equipment. As of September 30, 2017, SFSH had a balance payable to SDIPI of \$52 (December 31, 2016: \$39). For the three and nine months ended September 30, 2017, BSHS paid MPREH \$45 and \$135, respectively, for the use of a facility.

11.3 Other transactions

Certain of the physicians, who indirectly own the non-controlling interest in each of the Facilities, routinely provide professional services directly to patients utilizing the services of the Facilities and reimburse the Facilities for the space and staff utilized. Also, certain of the physicians serve on the boards of management of the Facilities and two such individuals perform the duties of Medical Director at the respective Facilities and are compensated in recognition of their contribution to the Facilities. Also, a physician with a non-controlling interest in SFSH is its Chief Executive Officer.

12. COMMITMENTS AND CONTINGENCIES

12.1 Commitments

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

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

12. COMMITMENTS AND CONTINGENCIES (Continued)

12.2 Contingencies

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

13. CEO TRANSITION

During the quarter, the Corporation obtained a full release and settled all amounts owing to the former CEO, who left the employ of the Corporation in June 2017. A charge of \$2,000 is included for this in general and administrative expenses in the interim condensed consolidated statements of income and comprehensive income for the nine months ended September 30, 2017.

14. SHARE BASED COMPENSATION

At the Corporation's annual and special meeting of shareholders held on May 12, 2016, shareholders approved a grant of stock options to acquire 1,000,000 common shares of the Corporation to its CEO. The grant was effective May 1, 2016, and the stock options are exercisable at C\$17.24 per share. At the time of the CEO transition, 223,562 of the options had vested, and 776,438 were forfeited. On September 19, 2016, stock options to acquire 350,000 common shares of the Corporation were granted to its Chief Development Officer, exercisable at C\$21.15 per share. On November 21, 2016, stock options to acquire 425,000 common shares of the Corporation were granted to its Executive Vice-President, Finance, who was appointed Chief Financial Officer on January 1, 2017, exercisable at C\$17.98 per share, subject to shareholder approval which was obtained at the Corporation's annual and special meeting of shareholders held on May 11, 2017. On May 5, 2017, stock options to acquire 350,000 common shares of the Corporation were granted to its Chief Operating Officer, exercisable at C\$16.47 per share. Outstanding options (the "Options") will vest after five years of employment, subject to the Corporation's maintenance of a dividend rate not less than the rate in effect at the time of the grant date.

During the three and nine months ended September 30, 2017, the Corporation recognized \$65 and \$268 (for the three and nine months ended September 30, 2016, \$57 and \$92), respectively, relating to the Options in salaries and benefits expense in the interim condensed consolidated statements of income and comprehensive income. The grant date fair values of the Options were measured based on the Black-Scholes model. Expected volatility is estimated by considering historic average share price volatility. The inputs used in the measurement of the fair values at the grant date of the share-based compensation plan are as follows:

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

14. SHARE BASED COMPENSATION (Continued)

	Q2 2017 Grants Issued	Q4 2016 Grants Issued	Q3 2016 Grants Issued	Q2 2016 Grants Issued
Fair value of Options, grants and assumptions				
Fair value at grant date	C\$ 1.27	C\$ 1.37	C\$ 2.00	C\$ 1.33
Share price at grant date	C\$16.68	C\$18.19	C\$21.57	C\$17.01
Exercise price	C\$16.47	C\$17.98	C\$21.15	C\$17.24
Expected volatility (weighted average volatility)	22.77%	21.77%	21.95%	23.60%
Option life (expected weighted average life)	5 years	5 years	5 years	5 years
Expected dividends	6.74%	6.18%	5.22%	6.61%
Risk-free rate	0.99%	0.99%	0.73%	1.03%

Compensation for directors includes a Deferred Share Unit (“DSU”) component, for which grants based on the value of the Corporation’s shares are made quarterly. For the three and nine months ended September 30, 2017, director compensation included DSU grants of \$87 and \$277 respectively (2016: \$75 and \$255), while the change in market value of outstanding DSUs for the same periods was an expense of \$11 and a recovery of \$11, respectively (2016: \$148 and \$720).

Compensation for executive officers of the Corporation include a Restricted Share Unit (“RSU”) component, for which grants based on the value of the Corporation’s shares are made annually and from time to time. The RSU grants vest over three years, participate in the Corporation’s monthly dividends and settle in cash. To date, grants were made on November 21, 2016 for 14,920 RSUs, and on July 1, 2017 for 21,804 RSUs. The value of the expense and liability associated with the RSUs is determined based on the Corporation’s stock price at the end of each reporting period. For the three and nine month periods ended September 30, 2017, salaries and benefits included RSU expense of \$74 and \$133, respectively. As at September 30, 2017, the liability for RSUs was \$145.

15. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by the Facilities.

15.1 Basis of measurement

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

15.2 Functional and presentation currency

The functional and presentation currency as presented in these financial statement is U.S. dollars.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Corporation translates monetary assets and liabilities denominated in Canadian dollars, principally its convertible debentures, exchangeable interest liability and certain of its cash balances, which are all denominated in Canadian dollars, at exchange rates in effect at the reporting date. Non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations were incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses, including translation adjustments, are included in the determination of net income.

15.3 Basis of consolidation

Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation (a) has the power over the entity, (b) is exposed, or has rights, to variable returns from its involvement with the entity, and (c) has the ability to use its power to affect its returns. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences, until the date that control ceases. Non-controlling interest represents the portion of a subsidiary's net earnings and net assets that are attributable to shares of such subsidiary not held by the Corporation.

The non-controlling interest in the equity of the Corporation's subsidiaries is included as a separate component of equity.

All intra-company balances and transactions have been eliminated in preparing these consolidated financial statements. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Corporation.

15.4 Business combinations

Business combinations are accounted for using the acquisition method as of the date when control is transferred to the Corporation. The Corporation measures goodwill as the excess of the sum of the fair value of the consideration transferred over the net identifiable assets acquired and liabilities assumed, all measured as at the acquisition date. Transaction costs that the Corporation incurs in connection with a business combination, other than those associated with the issue of debt or equity securities, are expensed as incurred.

Any contingent consideration is measured at fair value at the date of acquisition. If an obligation to pay contingent consideration that meets the definition of a financial instrument is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognized in net income and comprehensive income.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

At the date of the acquisition, the non-controlling interest is measured at the non-controlling interest's proportionate share of the fair value of identifiable assets of the acquiree. Contingent consideration in respect of those acquisitions, accounted for as exchangeable interest liability, is recorded on the balance sheet with periodic changes in fair value of that liability reflected in net income and comprehensive income.

15.5 Segment information

The operations and productive capacity of the Facilities revolve around the provision of surgical procedures. Each Facility is organized as an individual entity and separate financial statements are prepared for each entity. The chief operating decision makers of the Corporation, being the Chief Executive Officer and the Chief Financial Officer, regularly review performance of each individual Facility to make decisions about resources to be allocated to each Facility and assess their performance. Therefore, each Facility represents an operating segment as defined by IFRS 8 *Operating Segments*.

Management of the Corporation has concluded that the operating segments of the Corporation meet the criteria for aggregation pursuant to IFRS 8, *Operating Segments* and, therefore, discloses a single reportable segment. In forming its conclusion about the aggregation of the Facilities, management of the Corporation evaluated the long-term economic characteristics of each Facility, the comparative nature of the Facilities' operations, and the level of regulation of each Facility.

The services delivered by each Facility and the patients who use those services are similar. The vast majority of patients are insured through private insurance or government insurance programs (i.e., Medicaid or Medicare), which allows for a wide group of patients electing to have their procedures performed at one of the Facilities. The Facilities principally provide surgical amenities staff and pre- and post-surgical care related to surgeries. Finally, the Facilities have similar economic characteristics, which management defines as comparable long-term operating margins, recognizing differences between the Facilities in payor mix, surgical specialties and local healthcare markets.

15.6 Discontinued operations

A discontinued operation is a component of the Corporation's business which can be clearly distinguished from the rest of the Corporation, both operationally and for financial reporting purposes. Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held for sale. When an operation is classified as a discontinued operation, the comparative statements of comprehensive income are re-presented as if the operation has been discontinued from the start of the comparative year. Discontinued operations are excluded from the results of continuing operations and are presented as a single amount net of tax as net income from discontinued operations in the statement of income and comprehensive income.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

15.7 Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and all liquid investments purchased with a maturity of three months or less from the purchase date and which can be redeemed by the Corporation.

15.8 Short-term and long-term investments

Investments represent liquid investments purchased with a maturity of three months or more. Investments with maturities of more than three months but less than twelve months are classified as short-term and investments with maturities of twelve months or more are classified as long-term. The Corporation limits its exposure to credit risk through application of its investment policy. The policy permits investment of its cash and cash equivalents and short-term and long-term investments in (i) liquid securities issued or guaranteed by the Governments of Canada and the United States of America, or political subdivisions thereof and with (ii) certain Canadian chartered banks or banks regulated by the United States of America as listed in the policy. The carrying amount of investments represents the Corporation's maximum exposure to credit risk for such investments.

15.9 Accounts receivable

Accounts receivable are recorded at the time services are rendered at the amounts estimated to be recoverable from third-party payors and patients, by applying the following policies:

- (i) Amounts billed are reduced by an allowance for third-party payor adjustments which are maintained at a level management believes reflects the estimated adjustments that will be applied upon collection of the amounts billed. The allowance is established using the third-party payor contracts effective at period end and/or based on historical payment rates.
- (ii) An allowance for non-collectible receivable balances is recognized at a level management believes is adequate to absorb probable losses. Management determines the adequacy of the allowance based on historical data, current economic conditions, and other pertinent factors for the respective Facility. Patient receivables are written off as non-collectible when all reasonable collection efforts have been exhausted.

Payments from third-party payors are generally received within 60 days of the billing date. However, accounts involving non-contracted payment sources, such as auto and general liability insurance, are subject to recovery efforts, including rebilling and insurance litigation, until they are collected or considered not collectible. Residual amounts due from patients, such as co-payments and deductibles, are considered past due 30 days after receiving payment from third-party payors.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

15.10 Supply inventory

Supply inventory consists of medical supplies, including implants and pharmaceuticals. It is stated at the lower of cost or net realizable value, using the first-in, first-out valuation method.

15.11 Property and equipment

Property and equipment are stated at cost less accumulated depreciation. Cost includes expenditures that are directly attributable to the acquisition of the asset.

Depreciation of property and equipment is computed using the straight-line and declining balance methods over the estimated useful lives of the assets. Assets under finance leases are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Facilities will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of property and equipment are as follows:

Building and improvements	3-40 years
Equipment and furniture	3-20 years

Leases that substantially transfer the risk and benefits of ownership are capitalized with the cost included in property and equipment and the related liability recorded in long-term debt.

Depreciation methods, useful lives and residual values are reviewed on an annual basis.

15.12 Goodwill

Goodwill arises on the acquisition of subsidiaries and represents the excess of cost over the fair value of identifiable net assets acquired. For business acquisitions occurring after the date of transition to IFRS (January 1, 2010), goodwill is also recognized on non-controlling interest. Goodwill is stated at cost less accumulated impairment losses. Goodwill is not amortized but is reviewed at least annually for impairment and when events or changes in circumstances indicate that the carrying amount may not be recoverable.

15.13 Other intangibles

Other intangibles are recognized only when it is probable that the expected future economic benefits attributable to the assets will be realized by the Corporation and the cost can be reliably measured. Other intangibles represent the value of the hospital operating licenses, medical charts and records, care networks and trade names. Other intangibles are stated at cost less accumulated amortization and accumulated impairment losses, when applicable.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Upon recognition of an intangible asset, the Corporation determines if the asset has a definite or indefinite life. In making the determination, the Corporation considers the expected use, expiry of agreements, nature of assets, and whether the value of the assets decreases over time.

Amortization is recognized on a straight-line basis over the estimated useful lives of other intangibles, other than trade names, from the date they are available for use. The estimated useful lives of other intangibles are as follows:

Hospital operating licenses	5 years
Non-compete agreements	5 years
Medical charts and records	5-10 years
Care networks	10-18 years

Trade names represent the value assigned to the reputation of the hospitals and their standing in the business and local community which allow them to earn higher than average returns. Trade names are not amortized as there is no foreseeable limit to the period over which trade names are expected to generate cash inflows for the Corporation.

15.14 Impairment of non-financial assets

Non-financial assets that have an indefinite useful life, such as goodwill and trade names, are tested at least annually for impairment and when events or changes in circumstances indicate that the carrying amount may not be recoverable. Non-financial assets that have a definite useful life which are subject to amortization are reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

For the purposes of assessing impairment, assets are grouped at the cash generating unit ("CGU") level, which is the lowest level for which there are separately identifiable cash flows. Management considers each Facility as a CGU.

An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to dispose and value in use. Value in use is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognized in net income. It is allocated first to reduce the carrying amount of any goodwill allocated to the respective Facility and, then, to reduce the carrying amount of the other assets of the respective Facility on a pro rata basis.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

15.15 Financial assets and liabilities

The Corporation initially recognizes financial assets on the date that they originate or on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument. The Corporation derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. The Corporation assesses financial assets for impairment at each reporting date.

The Corporation initially recognizes financial liabilities on the date that they originate or on the trade date at which the Corporation becomes a party to the contractual provisions of the instrument. The Corporation derecognizes a financial liability when its contractual obligations are discharged, cancelled, or expire.

All financial assets and liabilities are initially recorded at fair value and designated into one of the following categories:

(i) Fair value through profit or loss ("FVTPL")

Cash and cash equivalents, certain short-term investments, convertible debentures and exchangeable interest liability are designated as FVTPL and are carried at fair value with unrealized gains or losses recognized through net income.

(ii) Held-to-maturity

Certain short-term and long-term investments are designated as held-to-maturity and are carried at amortized cost using the effective interest rate method.

(iii) Loans and receivables

Accounts receivable and other financial assets are designated as loans and receivables and are carried at amortized cost using the effective interest rate method.

(iv) Other liabilities

Interest payable, dividends payable, accounts payable, accrued liabilities, corporate credit facility and long-term debt are designated as other liabilities and are carried at amortized cost using the effective interest rate method.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

15.16 Impairment of non-derivative financial assets

Financial assets not designated as FVTPL, including interests in equity accounted investees, are assessed at each reporting date to determine whether there is objective evidence of impairment.

15.16.1 Financial assets measured at amortized cost

The Corporation considers evidence of impairment for financial assets measured at amortized cost on both an individual and collective basis. In assessing impairment, the Corporation uses historical information on the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that actual losses are likely to be greater or lesser than suggested by historical trends.

An impairment loss is calculated as the difference between an asset's carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Losses are recognized in net income and reflected in an allowance account. If the amount of an impairment loss subsequently decreases, then the amount is reversed through net income and comprehensive income.

15.16.2 Equity-accounted investee

An impairment loss in respect of an equity-accounted investee is measured by comparing the recoverable amount of the investment with its carrying amount. An impairment loss is recognized in net income and is reversed if there has been a favourable change in the estimates used to calculate that recoverable amount.

15.17 Measurements of fair value

A number of the Corporation's accounting policies and disclosures require the measurement of fair value for both financial and non-financial assets and liabilities.

The Corporation has an established control framework with respect to the measurement of fair values. The valuation of all fair value measurements is overseen directly by the Chief Financial Officer. Management of the Corporation regularly reviews significant unobservable inputs and valuation adjustments. If third-party information, such as broker quotes or pricing services, is used to measure fair values, then management assesses the evidence obtained from these sources to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

When measuring the fair value of an asset or a liability, the Corporation uses observable market data to the extent possible. Fair values are categorized into different levels in a fair value hierarchy based on the inputs used in the valuation technique as follows:

Level 1 – unadjusted quoted prices available in active markets for identical assets or liabilities;

Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or liability fall into different levels of the fair value hierarchy, then the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. The Corporation recognizes transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

15.18 Provisions

A provision is recognized if, as a result of a past event, the Corporation has a present legal or constructive obligation that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured at the estimated expenditures required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation. Provisions are discounted to their present values where the time value of money is material. All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

15.19 Convertible debentures

The Corporation's convertible debentures are convertible into a fixed number of common shares at the option of the holder. The number of common shares to be issued does not vary with changes in the market value of the convertible debentures.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

The convertible debentures are denominated in Canadian dollars while the Corporation's functional currency is U.S. dollars, which requires the Corporation to deliver a variable amount of cash to settle the obligation. Because the conversion option requires the Corporation to deliver a fixed number of common shares to settle a variable liability, the convertible debentures are considered hybrid financial instruments. The Corporation elected to account for the convertible debentures as a financial liability measured at FVTPL. The changes in the recorded amounts of the liability, resulting from the changes in the fair value of the convertible debentures and fluctuations in foreign exchange rates between the periods, are reflected in net income and comprehensive income.

15.20 Exchangeable interest liability

Exchangeable interest liability represents an estimated liability for the remaining portion of the interest in the Facilities held by the non-controlling interest which can be exchanged, subject to certain restrictions, for common shares of the Corporation. The exchangeable interest liability has been designated as FVTPL and accordingly is re-measured at the end of each reporting period taking into account (i) the calculated amount of common shares potentially issuable for the remaining portion of the exchangeable interest in the Facilities held by the non-controlling interest, (ii) the market value of common shares, and (iii) the exchange rate between Canadian and U.S. dollars at the end of the reporting period. The change in value of the exchangeable interest liability is included in net income and comprehensive income for the respective periods.

15.21 Facility service revenue

Facility service revenue consists of the actual amounts received and the estimated net realizable amounts receivable from patients and third-party payors. Facility service revenue is derived from the provision of the facilities and ancillary services for the performance of scheduled (as opposed to emergency) surgical, imaging, and diagnostic procedures. The Facilities bill either their patients or the patients' third-party payors as of the date of service upon completion of the procedure. Facility service revenue is recognized as of the date of the service when the recovery of consideration is probable and the Corporation is satisfied with the performance objectives.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

A small amount of facility service revenue is received directly from self-paying patients while the majority of facility service revenue is received from third-party payors that provide insurance and coverage to patients. Each Facility has agreements with third-party payors that provide for payments at amounts different from the Facility's established rates. Payment arrangements include pre-determined rates per diagnosis, reimbursed costs, discounted charges, and per diem payments. As a result of established agreements with third-party payors, settlements under reimbursement arrangements are determined with a high degree of accuracy and are accrued on an estimated basis in the period the services are rendered, and are adjusted in future periods, as final settlements are determined. Differences between the estimated amounts accrued and interim and final settlements are reported in operations in the period of settlement. Revenues relating to IMD's third party business solution service are included in facility service revenue, and consist of fees for business services provided to healthcare entities, recorded as services are provided and collection is reasonably assured.

15.22 Income taxes

Income tax expense (recovery) consists of current and deferred taxes. Income tax expense (recovery) is recognized in the statement of income and comprehensive income except to the extent that it relates to a business combination or items recognized directly in equity, in which case it is recognized in equity or in other comprehensive income.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted on the reporting date, and any adjustment to tax payable in respect of previous years.

The Corporation calculates deferred income taxes using the asset and liability method on temporary differences between the carrying amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are calculated, without discounting, at tax rates that are expected to apply to their respective period of realization, provided they are enacted or substantively enacted at the end of the reporting period. The effect on tax assets and liabilities of a change in tax rates is recognized in net income in the period that includes the date of enactment or substantive enactment.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized. Deferred tax liabilities are always recognized in full. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Corporation intends to settle its current tax assets and liabilities on a net basis. Deferred tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of temporary differences is controlled by the Corporation and it is probable that the temporary differences will not reverse in the foreseeable future.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

15.23 Share based payments

The Corporation has an equity settled, share-based compensation plan, under which the entity receives services from key executives as consideration for the options of the Corporation. The fair value of the services received in exchange for the grants of the options is recognized as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted.

Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. The total expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. When the options are exercised, the Corporation issues new shares. The proceeds received, together with the amount recorded in contributed surplus, are credited to share capital when the options are exercised.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of fully diluted earnings per share.

15.24 New and revised IFRS adopted

The Corporation has applied the following new and revised IFRS which are effective for periods beginning January 1, 2017, without any significant impact:

15.24.1 IAS 7 *Statement of Cash Flows*

As part of their disclosure initiative, the IASB has issued amendments to IAS 7 *Statement of Cash Flows* requiring a reconciliation of liabilities arising from financing activities to enable users of the financial statements to evaluate both cash flow and non-cash changes in the net debt of a company.

15.24.2 IAS 12 *Income Taxes*

In January 2016, the IASB has issued amendments to IAS 12 *Income Taxes* to provide clarification on the requirements relating to the recognition of deferred tax assets for unrealized losses on debt instruments measured at fair value.

15.25 New and revised IFRS not yet adopted

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

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

15.25.1 IFRS 2 *Share-Based Payments*

In September 2016, the IASB issued amendments to IFRS 2 *Share-Based Payments*. The amendments provide clarification on how to account for certain types of share-based payment transactions. The Corporation intends to adopt the amendments to IFRS 2 in its consolidated financial statements for the annual period beginning January 1, 2018.

15.25.2 IFRS 9 *Financial Instruments*

In July 2014, the IASB issued the complete IFRS 9 *Financial Instruments* ("IFRS 9 (2014)"). The mandatory effective date of IFRS 9 (2014) is for annual periods beginning on or after January 1, 2018 and must be applied retrospectively with some exemptions. The Corporation intends to adopt IFRS 9 (2014) in its financial statements for the annual period beginning on January 1, 2018. The Corporation is currently reviewing the impact of this standard and continues to evaluate the key differences if any. At this time, the extent of impact is not yet determined.

15.25.3 IFRS 15 *Revenue from Contracts with Customers*

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers* which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 11 *Construction Contracts*, IAS 18 *Revenue*, and the related Interpretations when it becomes effective. The new standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Corporation intends to adopt IFRS 15 in its consolidated financial statements for the annual period beginning on January 1, 2018. Based on its preliminary evaluation of the new standard, the Corporation expects its impact to be minimal.

15.25.4 IFRS 16 *Leases*

In January 2016, the IASB issued IFRS 16 *Leases*, which provides guidance for leases whereby lessees will recognize a liability for the present value of future lease liabilities and record a corresponding right of use asset on the balance sheet. There are minimal changes to lessor accounting. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted, provided IFRS 15 *Revenue from Contracts with Customers* has been adopted. The Corporation intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

MEDICAL FACILITIES CORPORATION

Notes to the Interim Condensed Consolidated Financial Statements
(In thousands of U.S. dollars, except per share amounts and where otherwise indicated)
For the three and nine months ended September 30, 2017
(Unaudited)

15. SIGNIFICANT ACCOUNTING POLICIES (Continued)

15.25.5 IFRIC 23 *Uncertainty over Income Tax Treatments*

In June 2017, the IASB issued IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments* in response to diversity in practice for various issues in circumstances in which there is uncertainty in the application of the tax law. While IAS 12 *Income Taxes* provides requirements on the recognition and measurement of current and deferred tax liabilities and assets, there is diversity in the accounting for income tax treatments that have yet to be accepted by tax authorities. The Interpretation is applicable for annual periods beginning on or after January 1, 2019 and may be applied on a fully retrospective basis, if this is possible without the use of hindsight, or on a modified retrospective basis, with an adjustment to equity on initial application. Earlier application is permitted. The Corporation intends to adopt IFRIC 23 in its financial statements for the annual period beginning on January 1, 2019.