LEISUREWORLD SENIOR CARE CORPORATION ANNUAL REPORT 2011

# Enduring value
# Leveraging strengths
# Growing opportunities

Leisureworld
A WHOLE NEW IMAGE OF AGE


## PROFILE:

Leisureworld is the third largest licensed long-term care (LTC) provider in Ontario. The Company owns and operates **26 LTC homes**, representing **4,314 beds** across Ontario, Canada. Leisureworld also owns and operates three retirement residences comprising 323 suites and one independent living residence with 53 apartments. Leisureworld subsidiaries include: Preferred Health Care Services, an accredited provider of professional nursing and personal support services; and Ontario Long Term Care, a provider of purchasing services and dietary, social work, and other regulated health professional services.


## OUR VISION:

To be the leader in providing quality care and creating an environment where our clients enjoy life to the fullest.

## OUR MISSION:

We make a difference...

- By **enriching** the lives of our clients through innovative programs and services.
- By **providing** peace of mind to families as we care for their loved ones with compassion, dignity and respect.
- By **building** an organizational culture of quality, safety and continuous improvement.
- By **fostering** a challenging and rewarding work environment that engages and fosters the growth of our talented employees.
- By **enhancing** and **sharing** our brand as a brand of excellence with our stakeholders and communities.

## OUR CORE VALUES:

**Respect** – We respect the uniqueness and values of each person and we demonstrate a caring and compassionate approach in all that we do.

**Commitment** – We are committed to delivering quality care and pursuing continuous improvement in all aspects of our operations.

**Teamwork** – We respect and rely on one another to achieve our common goals through collaboration and cooperation with employees and our external partners.

**Communication** – We are dedicated to fostering an environment of open and transparent communication with our employees, residents, families and our external stakeholders.

**Learning** – We fully support and encourage innovation, creativity, personal growth and professional development.

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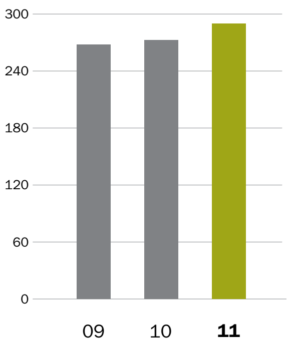
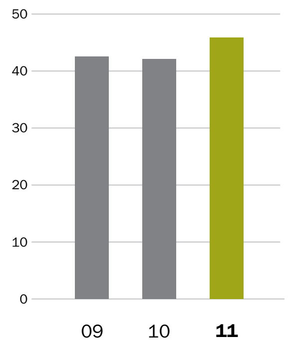
## 2011 Highlights

- Acquisition of **two luxury retirement residences** in Kanata and Kingston, ON
- Creation of new luxury retirement residence brand: **The Royale**
- Successful completion of **$46 million** equity offering
- Appointment of **Manny DiFilippo** as Chief Financial Officer
- Leisureworld added to **S&P/TSX SmallCap Index**
- Nine Leisureworld LTC homes receive inaugural **Residents First Improvement Award**
- Annualized shareholder dividend of **$0.85** per common share
- Annualized payout ratio of **73.6%**, outperforming the Company's targeted annualized payout ratio of 80%

### Revenue
(C$ millions)




### Net Operating Income
(C$ millions)



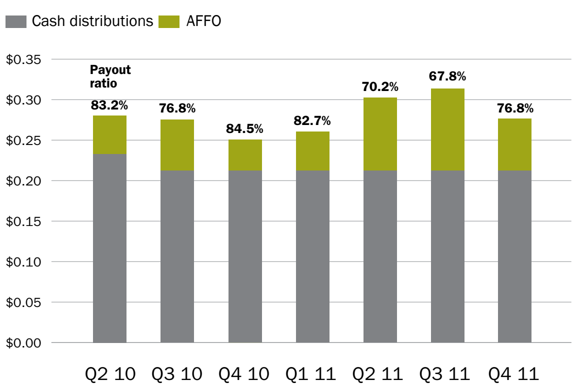

### Adjusted Funds from Operations (AFFO)
(Years ended December 31)

| (C$ thousands) | | 2011 | 2010[1] |
|---|---|---|---|
| **Net Operating Income (NOI)** | $ | **45,939** | 42,013 |
| Construction funding interest | | **3,111** | 3,624 |
| Net finance charges | | **(16,615)** | (15,866) |
| Current income taxes | | **(1,185)** | (1,922) |
| Administrative expenses | | **(14,134)** | (10,740) |
| Transaction costs | | **2,465** | 35 |
| **Funds from Operations (FFO)** | $ | **19,581** | 17,144 |
| Income tax book to filing adjustment | | **(739)** | – |
| HRIS expense | | **76** | (72) |
| Income support | | **3,105** | – |
| Construction funding principal | | **5,421** | 4,908 |
| Maintenance capex | | **(864)** | (1,400) |
| **Adjusted Funds from Operations (AFFO)** | $ | **26,580** | 20,580 |

[1] LSCLP's results until March 22, corporation's results thereafter.

## Key Performance Indicators

### Cash distribution & AFFO per share/Payout ratio



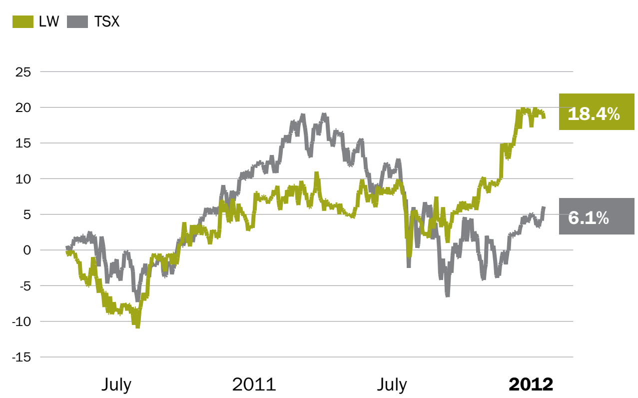

* The second quarter of 2010 includes a partial dividend payment for the month of March in the first quarter of 2010, as Leisureworld completed its IPO and listing as a public company on March 23, 2010.

### Occupancy

| | 2011 | 2010 |
|---|---|---|
| Average total occupancy (LTC) | **98.5%** | 98.5% |
| Average private occupancy (LTC) | **96.7%** | 97.1% |
| Average occupancy (retirement and independent living)** | **64.2%** | 94.3% |

** The 2011 retirement and independent living occupancy rates include the addition of the Kingston and Kanata properties as of April 27, 2011, which were acquired in lease-up and not yet at stabilized occupancy. The 2010 occupancy rates only include the Muskoka and Scarborough properties.

### Shareholder Returns (%)




Since Leisureworld completed its IPO in March 2010, the Company's common shares have outperformed the TSX Composite Index. LW common shares have appreciated in price by 18.4% over this time period, compared to 6.1% for the TSX Composite Index, with a total overall shareholder return of 37.7%, as of February 22, 2012.

## Message from the Chairman

"As we continue to build our LTC market presence and expand our operations across the continuum of seniors living, Leisureworld will maintain its focus on meeting or exceeding the highest standards in seniors care, while also providing additional quality lifestyle solutions to meet the evolving needs of Canada's aging population."

### Dear Shareholders:

On behalf of everyone at Leisureworld Senior Care Corporation, I am pleased to present our 2011 Annual Report. Leisureworld performed well in 2011, as our key performance indicators on page one of this report indicate, and our business grew with the acquisition of two luxury retirement homes and, early in 2012, with the planned acquisition of a "Class A" long-term care facility. We are making solid progress in advancing our strategy of leveraging our strengths and capturing opportunities to drive profitable growth.

The seniors care and living business presents attractive fundamentals for operators, including favourable demographics, strong and growing demand, government funding for long-term care and home care services, and attractive growth opportunities in the adjacent government-regulated segments of independent and assisted living residences and retirement homes, as well as professional home care. With a rapidly aging population, increasing life expectancies and increased wealth among seniors, proven service providers in seniors care and living have significant potential to deliver attractive shareholder returns by offering high-quality services across the continuum of seniors living.

At the same time, however, seniors care carries with it special obligations that aren't present in other businesses. In Leisureworld's core LTC business, we look after some of the most vulnerable members of our society. We provide care, we help manage their complex medical conditions and we enable our residents to live as full and active a life as they are able. Ultimately, the success of our core business depends on the trust that Leisureworld will always do what's right for its residents. That trust is, perhaps, our greatest asset and we protect it through a set of beliefs and behaviours that define how Leisureworld people serve our residents every day. Our vision, our mission and our core values are presented on the inside front cover of this report and I invite you to read and reflect on them.

I think you will quickly recognize that with more than 4,300 long-term care residents at 26 locations, living up to our high standards calls for our people to give of themselves all day, every day. It is no exaggeration to call these people special. From our Chief Executive Officer, David Cutler, who serves on the Board of the Ontario Long-Term Care Association, through to each of our dedicated employees, including Caroline Casey, Janet Lecky, Liza Reantaso, Mukesh Verma, and Mercidita Wilson, who were recipients of Leisureworld's Awards of Excellence in 2011, you can be assured of our commitment to care.

Leisureworld continued to improve the quality of care delivered in its LTC homes in 2011. We were proud that our efforts were recognized by Health Care Ontario – an independent government agency tasked with measuring and reporting on the quality of long-term care and resident satisfaction – as well as by the Canadian Institute for Health Information, which reported Leisureworld's better-than-average performance on 24 key quality-of-care indicators. Improving the quality of care is a never-ending commitment for us. That story is also covered in this annual report and it is at least as important as our company's financial and operating performance.

Leisureworld celebrates its 40th year of operations in 2012. We believe the company's longevity is a testament to the dedication and commitment of our employees, and our organization's shared vision, mission and values. As we continue to build our LTC market presence and expand our operations across the continuum of seniors living, Leisureworld will maintain its focus on meeting or exceeding the highest standards in senior care, while also providing additional quality lifestyle solutions to meet the evolving needs of Canada's aging population, for the benefit of all of our stakeholders.

**Dino Chiesa**, Chairman of the Board

# Corporate Governance

Leisureworld's Board of Directors is committed to the highest standards in corporate governance. This commitment supports the best interests of the company's shareholders and other stakeholders, by ensuring: effective implementation and execution of business strategies, risk management and financial controls; transparency of operational and financial performance; the company's overall adherence to ethical business practices; and, the definition of the roles and responsibilities of senior management and its performance. The Board also reviews, approves and authorizes publication of the company's quarterly interim and annual financial statements, including regulatory filings as required, and sets the company's dividend policy.

The duties and responsibilities of the Board of Directors are clearly separated from those of Leisureworld's management and do not include the day-to-day operation of the company's business. Members of the Board of Directors are selected for the skills and experience they bring and are elected by the shareholders. In addition to operating as a whole in ensuring the effective and ethical stewardship of the company, the Board operates through two important committees: (i) the Compensation, Nominating and Governance Committee, and (ii) the Audit Committee. Both of these committees consist of independent directors: John McLaughlin, Dino Chiesa, Jack MacDonald and Janet Graham.

Leisureworld's Compensation, Nominating and Governance Committee's primary responsibilities include: making recommendations concerning the appointment of executive officers; reviewing and assessing senior management performance and compensation, including that of the Chief Executive Officer; making recommendations on the nominations and appointments of new directors; and administering and making recommendations regarding the operation of employee incentive plans.

Leisureworld's Audit Committee's roles and responsibilities are set out in a charter and cover, generally, five functions: the quality and integrity of the company's financial statements; the internal control and financial reporting systems; compliance with legal and regulatory requirements in respect of financial disclosure; the qualification, independence and performance of the company's independent auditors; and the performance of the Chief Financial Officer. To be effective in these duties, the Audit Committee regularly meets separately with the CFO and the independent auditors. It is also empowered to engage outside advisors and experts in the fulfillment of its duties. The committee also reviews and assesses the adequacy of its charter.

Another important function of the Board of Directors is the dividend policy, which is determined exclusively by the Board. At the time of its March 23, 2010 initial public offering (IPO), Leisureworld set a target dividend payout ratio amounting to less than or equal to 80% of total Adjusted Funds from Operations (AFFO) and totalling $0.85 annually, which it has achieved.

Further information on Leisureworld's corporate governance practices is contained in the company's Annual Information Form and other regulatory filings, available at www.sedar.com.

**Independent members of Leisureworld's Board of Directors**
Dino Chiesa
Jack MacDonald
Janet Graham
John McLaughlin

## Message from the Chief Executive Officer

"By building our presence in other seniors living markets, we have opportunities to leverage our operating strengths, grow our less regulated revenue streams, and further enhance operating margins, while supporting consistent shareholder dividends."

Leisureworld is committed to providing its residents and clients with exceptional quality of care, services and lifestyle options that enable them to enjoy their lives to the fullest. Our long-term goal is to be among the most respected, reliable and comprehensive seniors living service providers in Canada. In 2011, we continued to meet our commitments, and made solid progress in advancing our strategic objectives. Highlights of the year included:

- Continued high occupancy rates at our long-term care (LTC) homes, with 98.5% average total occupancy at year-end and more than 96% occupancy for private accommodations;
- Nine of our LTC homes being honoured with the "Residents First Improvement Award" by Health Quality Ontario;
- Our acquisition of two luxury retirement residences in Kanata and Kingston, Ontario;
- The launch of our new luxury retirement residence brand The Royale;
- The successful completion of a $46 million equity offering;
- Leisureworld's inclusion in the S&P/TSX SmallCap Index;
- The distribution of consistent monthly dividends to our shareholders totalling $0.85 per share annualized; and,
- Strong financial performance.

### Strong financial performance

We achieved solid growth in Net Operating Income (NOI), and Adjusted Funds from Operations (AFFO) in 2011. NOI increased 9.3% to $45.9 million in 2011, from $42.0 million in 2010, and AFFO increased 29.2% to $26.6 million. AFFO is a key measure for Leisureworld's shareholders, as it indicates the amount of cash we are generating that is available to fund shareholder dividends. Our AFFO payout ratio for 2011 was 73.6%, outperforming our target payout ratio of 80% despite the issuance of an additional 4.4 million common shares through our equity offering in April. We believe this demonstrates the stability of our business and our ability to support reliable shareholder dividends as we execute our growth strategy.

### Advancing our growth strategy

While our primary business focus remains the government regulated and funded LTC market, we are committed to positioning Leisureworld as a leading Canadian provider of facilities and services across the continuum of seniors living. By building our presence in other seniors living markets, such as independent living, retirement homes, assisted living centres, and home healthcare, we have opportunities to leverage our operating strengths, grow our less-regulated revenue streams, and further enhance operating margins, while supporting consistent shareholder dividends.

We made significant progress in advancing our growth strategy in 2011 with the acquisition of The Royale retirement properties, and our subsequent progress in advancing the lease-up of our new properties. As our Royale retirement residences were essentially new when we purchased them, the properties are currently in the initial lease-up period. We revitalized local marketing campaigns shortly after closing the transaction, and have been steadily increasing occupancy in line with our average target growth rate of 2.5 net new resident move-ins per property, per month. In the fourth quarter we added 22 net new move-ins, bringing year-end occupancy rates at the Kingston and Kanata residences to 64.7% and 60.1%, respectively. We are on track to meet our target of 90% occupancy by the second half of 2013.

We will also continue to evaluate opportunities to augment our core LTC portfolio, either through the renewal of our older facilities or through complementary acquisitions. Subsequent to year-end, in January 2012, we entered into an agreement to acquire a 160-bed "A" Class LTC facility in Orleans, Ontario, just outside of Ottawa. Subject to approval by the Ontario

Ministry of Health and Long-Term Care (MOHLTC) and the Local Health Integration Network, this transaction will enhance our existing portfolio of LTC homes in Ontario and build our broader seniors living market presence in the Ottawa area. Both of the aforementioned transactions are consistent with our commitment to make acquisitions that are accretive to AFFO, thereby adding further support for our shareholder dividends.

**Well positioned in an industry with positive fundamentals**
Leisureworld is well positioned in an industry with extremely positive fundamentals. Canada's aging population, changing family dynamics, increasing life expectancies and increasing seniors' affluence are all driving demand for more seniors living capacity and options.

The primary demographic group living in LTC homes, retirement residences, assisted living and independent living communities are Canadians who are 75 years of age and older. According to Statistics Canada, the 75-plus and 85-plus age cohorts are expected to more than double in size by 2035. Given the burgeoning size of this demographic group, we believe that current options and capacity for seniors living and care will be strained in future.

As the Province of Ontario and other provinces look for ways to contain healthcare spending, we believe that private delivery of services in seniors living and care by trusted providers, such as Leisureworld, represents a cost-effective solution. There are currently 77,500 LTC beds in Ontario and a wait list of more than 20,000 individuals. Many of the individuals currently on wait lists for LTC beds are occupying acute care beds in Ontario hospitals, which, according to the MOHLTC, cost the taxpayer an average of $1,000 a day, compared to base funding of just $152.94 a day in an LTC home. Further, if governments determine that in addition to LTC homes an increased focus on home care is also required to meet the acute care needs of seniors, our Preferred Health Care Services subsidiary is well positioned to benefit.

Given the increasing life expectancies and evolving lifestyle expectations of healthy Canadian seniors, we believe growing opportunities are emerging to meet the preferences of these individuals as well. Seniors that are affluent, and in good health and prefer ready access to care and services in a community setting are becoming increasingly discerning about their lifestyle options. Contemporary retirement homes and independent or assisted living centres that offer larger living units, luxury features and shared amenities, typically found in preferred hotels and condominiums are becoming more attractive. Leisureworld has a number of competitive advantages that it can apply to become a preferred, cost-effective provider in this market, including: property management expertise, favourable access to capital, knowledge of government regulations, expertise in seniors services and care, and the scale of operations to achieve low-cost procurement of supplies.

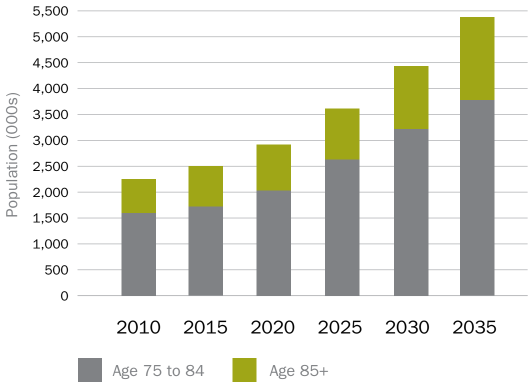
**Looking ahead**
While challenges lie ahead in meeting the quality of living and care requirements of Canada's aging population, we believe Leisureworld is well positioned to be part of the solution. Looking ahead, your company will remain focused on building value for our stakeholders, by:

- ensuring exceptional quality seniors care and services;
- supporting and increasing our occupancy rates;
- maintaining disciplined cost management;
- identifying opportunities to augment our LTC portfolio;
- expanding our presence across the continuum of seniors living; and
- maintaining a strong balance sheet.

**Acknowledgements**
On behalf of our Board of Directors and senior management team, I would like to thank each of our valued employees for ensuring the quality of care, services and lifestyle options that Leisureworld residents, home care clients and their family members have come to expect. As we celebrate our 40th year of operations in 2012, we also celebrate your many contributions. Finally, to our shareholders, on behalf of everyone at Leisureworld, we thank you for your continued support.

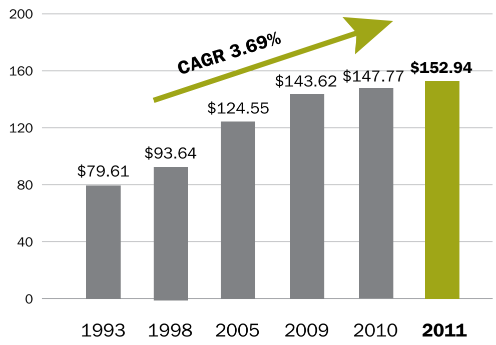
**David Cutler,** Chief Executive Officer


**Favourable Demographics** (estimated population in Canada's 75 to 84 and 85+ age cohorts)




Source: Statistics Canada – Canada Year Book 2011

**MOHLTC Funding** (base per diem funding per LTC bed) (C$)



# Enduring Value

### Large scale, complex care

Leisureworld owns and operates 26 long-term care homes across Ontario, making it the province's third largest LTC provider. We provide continuing care for more than 4,300 residents, who average 86 years of age, typically have multiple serious medical conditions, and take eight to 10 medications per day, and more than 60% are cognitively impaired. They require 24/7 medical care and assistance and in many cases are provided with complex care such as peritoneal dialysis, tube feeding, IV therapy, and hypodermocylsis. This distinguishes the LTC segment of senior care from unlicensed and privately funded retirement and independent living homes.

### High barriers to entry

Due to the complexity of care provided by LTC operators in Ontario, LTC is highly regulated by the MOHLTC. Operators must meet stringent licensing requirements and adhere to a common set of Ministry rules, as well as public health, safety and privacy laws. No new LTC licences have been granted in Ontario in the past eight years. The complexity of care combined with government regulations and licensing requirements creates high barriers to entry for potential new participants.

### Reliable government funding

As LTC is deemed by the province to be an essential service and a vital part of community infrastructure, it is also government funded. All of the care and basic accommodations are supported by government programs. This funding is driven by need, and not by general economic conditions. The government has a strong financial incentive to support LTC, as the cost to fund a senior patient in a hospital acute care bed is approximately $1,000 per day and the cost of a chronic care bed in an Ontario hospital averages $650 a day, while base funding costs for an LTC bed are just $152.94 per day. MOHLTC funding for LTC has consistently increased over time, as the chart on the opposite page illustrates. The LTC segment contributed approximately 92% of Leisureworld revenues in 2011.

### Growing demand

There are currently about 77,500 licensed long-term care beds in Ontario and a wait list of more than 20,000 seniors trying to get into them. Further, given the demographic trends in Ontario, demand will continue to increase. According to provincial government estimates, Ontario residents in the 75-plus age cohort will grow by 30% over the next 10 years, and by approximately 130% between 2011 and 2035.

### Stable, high occupancy

LTC homes that meet or exceed 97% average annual occupancy receive MOHLTC funding based on 100% occupancy. Leisureworld's average total LTC occupancy was 98.5% in 2011 and has consistently exceeded the 97% occupancy threshold since 2008, when Leisureworld was in a temporary build-up phase due to acquisitions.

Leisureworld can increase revenues by designating up to 60% of our beds for private or semi-private accommodation, which adds $18 or $8 per day, respectively, to our revenue. These additional resident-paid fees for private accommodation accounted for 23% of our Net Operating Income in 2011.

Further, new LTC homes (those built in the last 12 years) are eligible for $10.35 in construction funding per bed, per day from the MOHLTC. Approximately 52% of Leisureworld's LTC homes are currently eligible for construction funding. This construction funding has a term of approximately 14 years remaining, representing $93 million in support of our AFFO.

While government funding provides cash flow stability, Leisureworld's demonstrated ability to maintain high total and private occupancy, combined with our newer homes, serves to enhance cash flow, providing strong support for our dividend.

**"Leisureworld has a stable core business with strong fundamentals that support our enduring value and reliable shareholder dividends."**

**David Cutler,** Chief Executive Officer

## Management team

**Leisureworld senior management team members (above) include: Marg Toni, VP, Quality and Risk Management; Paul Rushforth, COO; David Cutler, CEO; Manny DiFilippo, CFO; Tracy Jones, President, Preferred Health Care Services, and Josephine DesLauriers, VP, Human Resources.**

preferred
HEALTH CARE SERVICES

**Since 1987, Preferred Health Care Services has been providing registered nurses, registered practical nurses, healthcare aides and personal support workers for long-term care homes and private care. Staff have specialty training in the areas of palliative care, gerontology, cognitive impairment, acquired brain injury and post-surgical recovery.**

# Leveraging Strengths

As we advance our growth strategy and expand our presence across the continuum of seniors living, we have significant opportunities to leverage our strengths in property management, access to low cost of capital financing, government relations, human resources, our knowledge of senior services and care, and our scale of operations, to build value for our stakeholders.

Leisureworld has been an owner/operator of LTC homes in Ontario for 40 years, expanding to its current portfolio of 26 LTC homes, three retirement properties and an independent living centre. We have also developed complementary professional service organizations with our Preferred Health Care Services, an accredited provider of professional nursing and personal support services; and Ontario Long Term Care, a provider of purchasing services, dietary, social work, and other regulated health professional services. Over this time, we have developed operational expertise in our core functions through consistent processes, best practices and experience.

### Operations

Our executive team fosters a culture of quality across our enterprise by measuring, monitoring and auditing performance in care and services. We engage with staff at all levels, through discussion, reports, and analysis, to establish best practices and revisions to benchmarks and to develop training and educational initiatives. Each of our properties has its own on-site management team who are supported by our regional and corporate staff in areas of focused expertise. On-site management teams are also supported by networking and collaborations with teams from other properties in our portfolio. This network integration, depth of resources and shared expertise provide us with a competitive edge in the critical areas of resident and client care; property development, maintenance and upgrades; budgeting and finance; sustaining optimal resident occupancy levels; cost-efficient, high-volume procurement of supplies; and human resource management.

### Industry relations

We have developed strong relations with key industry participants in the MOHLTC, Local Health Integration Networks (LHINs), real estate development and finance, and municipal planning and zoning departments so we can make informed planning decisions and efficiently advance our growth initiatives.

### Finance

The efficiency of our operations and capital structure supports our strong financial credit ratings, including A (Stable) from DBRS, and A-minus (Stable) from S&P. This enables us to access low cost of capital financing to fund our growth initiatives. In future, we expect to secure, as necessary, low-cost mortgages on our properties through the use of Canada Mortgage and Housing Corporation (CMHC) mortgage insurance. CMHC provides mortgage insurance to financial institutions to allow them to lend money to qualified building owners, like Leisureworld, at interest rates significantly below those offered by conventional lenders. Further, as a public company, we can also access growth capital through equity offerings, as we did in 2011 to partially fund our Royale acquisition. Our strong business fundamentals and operational expertise enable us to deliver stable and predictable cash flows and maintain a strong balance sheet which, in turn, provides us with the financial flexibility to pursue value-enhancing, growth opportunities.

### Human resources

As we expand our operations across the spectrum of seniors living we can offer our employees a broader array of career development opportunities and provide enhanced job stability. Our people are our greatest resource and by helping them succeed we build value across our enterprise. We will also be able to extend our relationships with our clients as they come to know the Leisureworld brand as one of Canada's most comprehensive and trusted providers of seniors care and living solutions.

**"As we advance our growth strategy and expand our presence across the continuum of seniors living, we have significant opportunities to leverage our strengths."**

**Manny DiFilippo**, Chief Financial Officer



THE ROYALE

## The Royale Retirement Residences

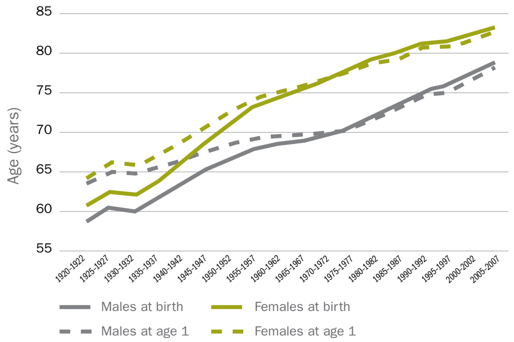
**The Royale Kanata and The Royale Kingston are newly constructed, best-in-class retirement communities that feature spacious designs, luxury amenities and professional staff. They embody the grandeur of a fine hotel, yet have the warmth and comfort of one's own home.**

### Increased affluence of seniors/families

**allows seniors to afford a much higher quality housing product with greater amenities than at any time in the past. Seniors' housing is now more upscale and residential, compared to the institutional feel that previously characterized such facilities.**

### Increasing Life Expectancy Age (years)

Life expectancy in Canada at birth and at age 1



# Growing Opportunities

## Expanding our presence across the continuum of seniors living

Canada's aging population, changing family dynamics, increasing life expectancies and increasing seniors' affluence are all driving demand for greater seniors living capacity and options. To capitalize on these trends, we're positioning Leisureworld to be a leading participant in a broader market beyond our core LTC business, by providing facilities and services across the entire continuum of seniors living in Canada. We're evaluating growth opportunities in the complementary segments of independent and assisted living centres, retirement homes, and home healthcare.

### The Royale

Our acquisition of the luxury retirement residences in Kanata and Kingston, Ontario, is consistent with this strategy. Through this transaction, we increased our asset base by approximately 16%, diversified our business through expansion in one of the fastest growing segments of the seniors living market, and created our new luxury retirement residence brand: The Royale.

The Royale in Kanata, Ontario, just outside Ottawa, is a five-storey, 148,500 square foot property. The building has 158 suites ranging from 420 to 1,184 square feet. Assisted living is provided on one of the floors. The Royale in Kingston, Ontario, is a five-storey, 140,000 square foot property. The building has 136 suites ranging from 410 to 870 square feet. The properties feature five-star luxury amenities, including intimate dining rooms, indoor pools, movie theatres, spacious lounges, landscaped grounds, wireless internet connectivity and fitness facilities.

The provision of these five-star features and amenities enables us to optimize lease rates and realize superior operating margins compared to our LTC homes. In addition, we can also offer à la carte services, such as chauffeured town cars, dog walking, or cooking classes, to further enhance margins.

### Preferred Health Care Services (PHCS)

Our PHCS subsidiary offers professional home care, education, training and relief staffing services. These services either complement or support our core LTC resident care operations. The Government of Ontario recently commissioned the Drummond Report, which provides recommendations for reforms to Ontario's public services in order to reduce the province's deficit. The report strongly recommends increased support for home-based care. Our PHCS subsidiary is well positioned to benefit from an increased emphasis on home care. We intend to evaluate growth opportunities for our home care operations through internal development and acquisitions.

## Augmenting our LTC assets

As we build our non-LTC portfolio, we will also focus on opportunities to augment our core LTC assets.

### LTC Capital Renewal

The MOHLTC has committed to a capital renewal program for LTC operators in Ontario to upgrade their Class B and C homes to Class A standards. Leisureworld has 12 Class B and C homes (representing 2,054 beds) that are eligible. The capital renewal program that is currently under review by the government would enable us to upgrade our Class B and C beds to Class A and receive higher per diem subsidies per upgraded Class A bed, as compared to our existing Class A beds. We would also be able to optimize our private accommodation to 60% of capacity, and thereby significantly enhance our preferred accommodation resident fees. Redevelopment of our Class B and C homes is expected to occur over the next five to fifteen years, subject to MOHLTC requirements.

### LTC Acquisitions

The LTC industry in Ontario is highly fragmented with the top 10 operators controlling less than 40% of the market. This presents strong opportunities for large, professionally managed operators, like Leisureworld, to consolidate the market and enhance margins through economies-of-scale.

**"We're positioning Leisureworld to be a leading participant in a broader market beyond our core LTC business, by providing facilities and services across the entire continuum of seniors living in Canada."**

**David Cutler,** Chief Executive Officer


Leisureworld staff participates in corporate fundraising for the Alzheimer Society


Leisureworld's 2011 Awards of Excellence

## Awards of Excellence

**Each year the Award of Excellence honours employees who exemplify, reinforce and promote our core values: Respect, Commitment, Teamwork, Communication and Learning. 2011 award winners (at left, seated) include: Caroline Casey, Janet Lecky, Mercidita Wilson, Liza Reantaso, and Mukesh Verma. Joining them above are David Cutler, CEO; Tracy Jones, President, PHCS; Josephine DesLauriers, VP, Human Resources; and Paul Rushforth, COO.**


The Art of Living Exhibit, Toronto Centre for the Arts, June 2011

## The Art of Living

**The Art of Living celebrates life through the art of Leisureworld's residents. Leisureworld communications specialist Ruth Ramirez describes the Art of Living as "a unique event for a community of seniors that captures the beauty produced by them with their hands, hearts and souls." The 2011 exhibit of creative works by Leisureworld residents was held at the Toronto Centre for the Arts.**

# Quality Care and Community Involvement

Leisureworld continually seeks to improve the quality of care in its homes through initiatives that include enhancing operational performance, maintaining seniors' connections with each other and the community, and celebrating the efforts of its people in making a positive difference in residents' lives.

### Quality care

We are proud to note that nine of our LTC homes were recently honoured with the inaugural "Residents First Improvement Award" by Health Quality Ontario, an independent government agency tasked with measuring and reporting on the quality of long-term care and resident satisfaction in Ontario. The Residents First Improvement Award is an innovative program that recognizes the LTC homes in Ontario that have made significant progress in advancing new and challenging quality improvement (QI) initiatives aimed at enhancing quality of care for residents. Staff members from our Etobicoke LTC home were selected by the Institute for Healthcare Improvement to present one of their QI initiatives at its annual global conference in Orlando, Florida, in December 2011.

Based on recent data from the Canadian Institute for Health Information, Leisureworld performed better than the provincial average for LTC operators on 24 of Ontario's 35 key quality-of-care indicators. We intend to continue building on our quality-of-care achievements going forward. Leisureworld launched a LEAN initiative in 2011 with the purpose of improving our internal process efficiency and putting the time saved towards enhancing our LTC resident care. To date, our LEAN projects have resulted in significant time savings annually. Ninety-two employees are now trained as LEAN "White Belts," and 11 of our people are now certified as LEAN "Yellow Belts." These accomplished staff members will serve as mentors and monitors for an expanding team focused on continuous improvement.

### Community involvement

One way Leisureworld helps its senior care residents retain their connections to the community is through the shared celebration of imagination and creativity through artistic expression. The 2011 program, The Art of Living, was Leisureworld's third exhibition of our residents' work and featured the paintings, poems, photographs, embroidery and sculpture of 27 residents from 21 of our long-term care and retirement homes on display June 23–25, 2011 at the Toronto Centre for the Arts. The gala opening evening saw residents, their families and Leisureworld staff welcomed on a red carpet, with wine and hors d'oeuvres and piano entertainment, as well as a performance by the Leisureworld Richmond Hill residents' choir.

In another community initiative, Leisureworld residents from a number of homes, families, volunteers and employees also participated in the Alzheimer Walk for Memories in downtown Toronto in late January. Walking together and some rolling in wheelchairs, the Leisureworld contingent contributed a total of $16,000 for the cause, which included a $5,000 corporate donation to the Alzheimer Society.

### Employee Awards of Excellence

In 2011, 430 Leisureworld employees were nominated for the company's annual Award of Excellence program for their contributions to quality care for Leisureworld's long-term care residents and home care clients. The awards program recognizes employees' work in five broad categories: respect, commitment, teamwork, communication and learning, which reflect the profound, positive impact of our employees on residents, clients and family members. Nominations were submitted by fellow employees, residents, clients (and their families) of Leisureworld and PHCS. Award winners in each category received a statuette, a plaque, a $1,000 monetary award and a $500 donation to the charity of their choice in a mid-November presentation ceremony.

**"Quality care, respect and providing opportunities for our residents to enjoy life to the fullest have been at the core of everything we do for the past 40 years. It's part of our DNA at Leisureworld."**

**Paul Rushforth,** Chief Operating Officer

# MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Quarter and Year Ended December 31, 2011 (In Canadian Dollars)

MD&A

**The following Management's Discussion and Analysis ("MD&A")** for Leisureworld Senior Care Corporation ("Leisureworld", "LSCC" or the "Company") summarizes the financial results for the quarter and year ended December 31, 2011. This discussion and analysis of Leisureworld's consolidated operating results, cash flow and financial position for the quarter and year ended December 31, 2011 should be read in conjunction with the audited consolidated financial statements and related notes contained in this financial report. Additional information relating to the Company is available on SEDAR at www.sedar.com. The information contained in this report reflects all material events up to February 22, 2012, the date on which this report was approved by the Board of Directors of Leisureworld.

As of February 21, 2012 there were 24,490,149 shares outstanding.

The discussion and analysis of the operating results for the twelve-month period compares the consolidated operations of Leisureworld to the combined results of Leisureworld Senior Care LP ("LSCLP") up to March 23, 2010, the date of acquisition, and the Company's results from March 23, 2010 to the end of the period. All financial information has been prepared in accordance with International Financial Reporting Standards ("IFRS"). All amounts have been expressed in thousands of Canadian dollars, unless otherwise noted.

## FORWARD-LOOKING STATEMENTS

Certain statements in the following discussion and analysis may constitute forward-looking statements that involve known and unknown risks, uncertainties and other factors, which may cause the actual results to be materially different from any future results expressed or implied by such forward-looking statements. When used in the following discussion and analysis, such statements use words such as "may," "will," "expect," "believe," "plan" and other similar terminology. These statements reflect current expectations regarding future events and operating performance and speak only as of the date of this discussion and analysis. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved.

The forward-looking statements contained in this discussion and analysis are based on information currently available and what management currently believes are reasonable assumptions. However, neither Leisureworld nor management can ensure actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this discussion and analysis, and Leisureworld and management assume no obligation to update or revise them to reflect new events or circumstances. Leisureworld and management caution readers not to place undue reliance on any forward-looking statements, which speak only as of the date made.

## INTRODUCTION

Leisureworld was incorporated under the laws of the Province of Ontario on February 10, 2010 and was continued under the laws of the Province of British Columbia on March 18, 2010. The Company closed its Initial Public Offering ("IPO") on March 23, 2010 and acquired, indirectly, all of the outstanding limited partnership interest in LSCLP and common shares of Leisureworld Senior Care GP Inc., the general partner of LSCLP.

## CORPORATE OVERVIEW

Leisureworld and its predecessors have been operating since 1972. Leisureworld is the third largest licensed long-term care ("LTC") provider in the Province of Ontario and the largest participant in the Canadian seniors' housing sector that has focused almost exclusively on Ontario LTC. Leisureworld owns and operates 26 LTC homes (representing an aggregate of 4,314 beds), all of which are located in the Province of Ontario. Leisureworld also owns and operates three retirement residences ("RR") (representing 323 suites) and one independent living residence ("IL") (representing 53 apartments) in the Province of Ontario. Ancillary businesses of the Company include: Preferred Health Care Services ("PHCS"), an accredited provider of professional nursing and personal support services for both community based home healthcare and LTC homes; and Ontario Long Term Care ("OLTC"), a provider of purchasing services, as well as dietary, social work, and other regulated health professional services to Leisureworld homes.

The objectives of Leisureworld are to: (i) provide shareholders with stable monthly dividends derived from revenues generated from income-producing LTC homes, seniors' housing investments and community based services; (ii) enhance the long-term value of the Company's assets and maximize shareholder value; and (iii) expand the asset base of the Company through accretive acquisitions and construction of new LTC and seniors' living homes and other healthcare related business opportunities.

## INDUSTRY OVERVIEW

LTC homes are designed to accommodate seniors who require 24-hour per day care and suffer from cognitive or physical impairment. LTC homes offer higher levels of personal care and support than those typically offered by independent living facilities or retirement residences. All Ontario LTC homes must be licensed by the Ministry of Health and Long-Term Care ("MOHLTC") and are eligible for occupancy based government funding, while being subject to government regulation and care standards. Residents of LTC homes are directly charged only for accommodation costs and, in the event these amounts are unaffordable for the residents, government subsidies are available to reduce the basic accommodation charge. Residents of LTC homes can pay a higher accommodation rate for private and semi-private accommodation ("preferred occupancy").

Retirement communities accommodate seniors who require minimal to moderate assistance with activities of daily living whereas independent living communities accommodate seniors who require minimal or no assistance with daily living. RR in Ontario are now regulated but generally are not subsidized by the government. The "Retirement Homes Act, 2010" received Royal Assent on June 8, 2010. This legislation will provide consumer protection and does not provide funding for the provision of care and services in these facilities. There will be a delayed implementation of certain sections of the Act, including licensing provisions. Residents are generally responsible for the entire cost of accommodation and care.

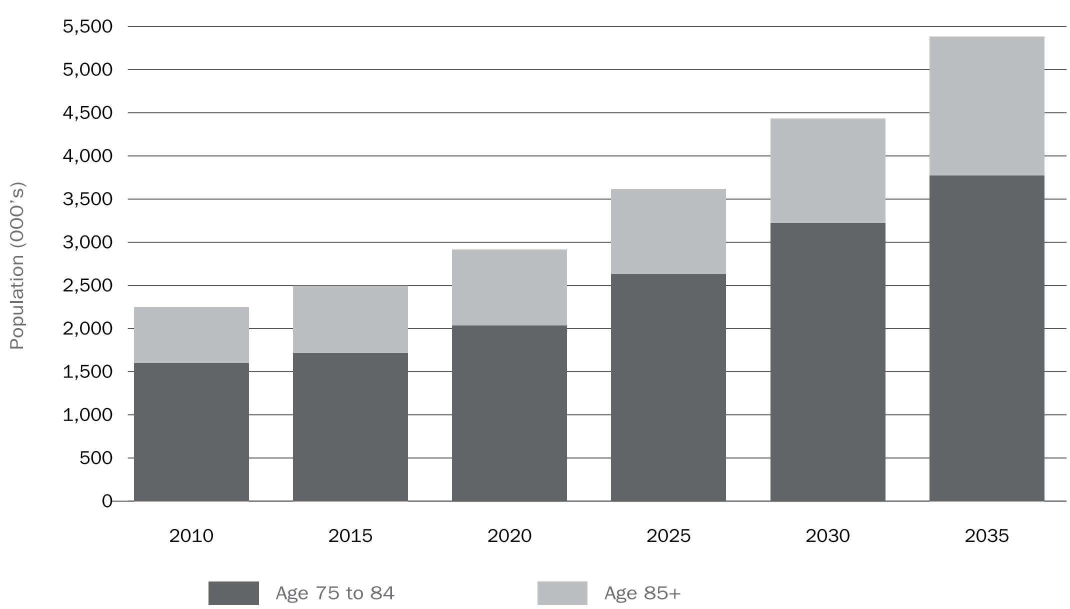
Home healthcare services in Ontario are designed to accommodate seniors that require assistance in day-to-day activities and healthcare. Funding for such services is provided by Ontario's Community Care Access Centres ("CCACs"). CCACs were created by the MOHLTC partially to administer publicly funded home care in the Province of Ontario. In 2006, as part of its "Aging at Home" initiative, the Government of Ontario announced its intention to fund, over a period of over three years, up to $700 million to provide a wider range of home care and community support services to enable seniors to continue leading healthy and independent lives in their own homes. Currently, Leisureworld's PHCS holds three CCAC contracts for personal support worker services. The MOHLTC, Ontario's Local Health Integration Networks ("LHINs") and CCACs are now moving forward with "Home First", a similar initiative to "Aging at Home", designed to support seniors with government subsidized home healthcare and community services.

**Demand and supply**

The demand for seniors' housing and programs continues to grow in the Province of Ontario. Management believes favourable demographics, increasing life expectancy, increasing seniors' affluence and changing family dynamics have and will continue to have a positive impact on demand for LTC, RR and IL accommodations ("seniors' housing") and for professional home healthcare services in the Province of Ontario.

- Favourable demographics: The primary demographic group living in LTC homes, RR and IL communities are Canadians who are older than 75 years of age. According to Statistics Canada, the 75-plus and 85-plus age cohorts in Canada are anticipated to be among the fastest growing age cohorts over the next 20 years, with the 85-plus age cohort expected to increase approximately 23% between 2010 and 2015. The same cohorts are expected to more than double in population by 2035.

**ESTIMATED POPULATION IN CANADA'S 75 TO 84 AND 85+ AGE COHORTS**

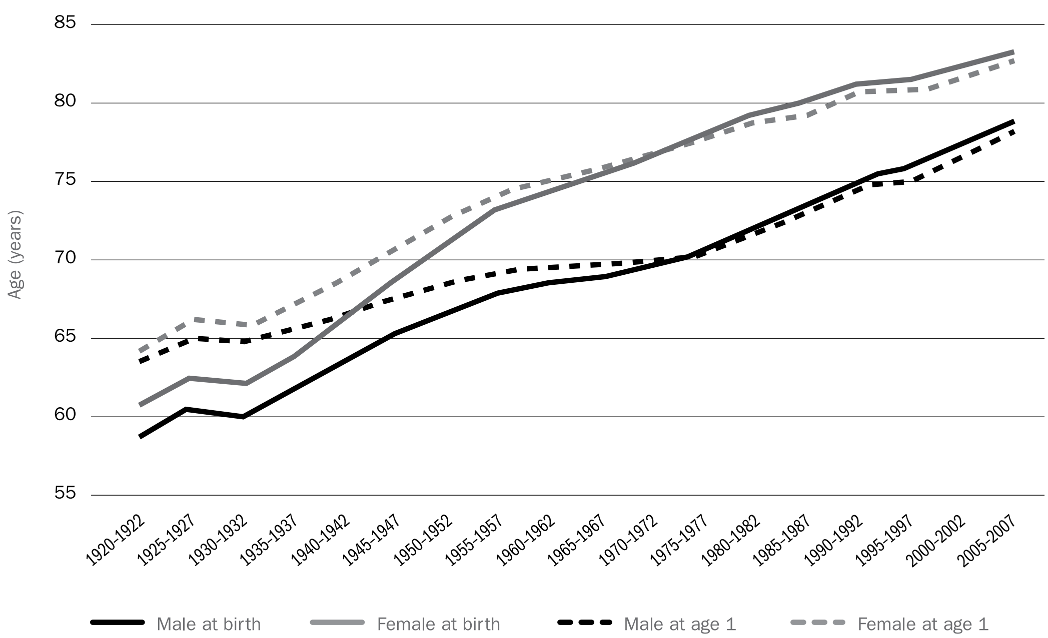



Source: Statistics Canada – Canada Year Book 2011

According to provincial government estimates, Ontario residents in the 75-plus age cohort will grow by 30% over the next 10 years, and there will be approximately 130% growth in Ontario's 75-plus age cohort between 2011 and 2035.

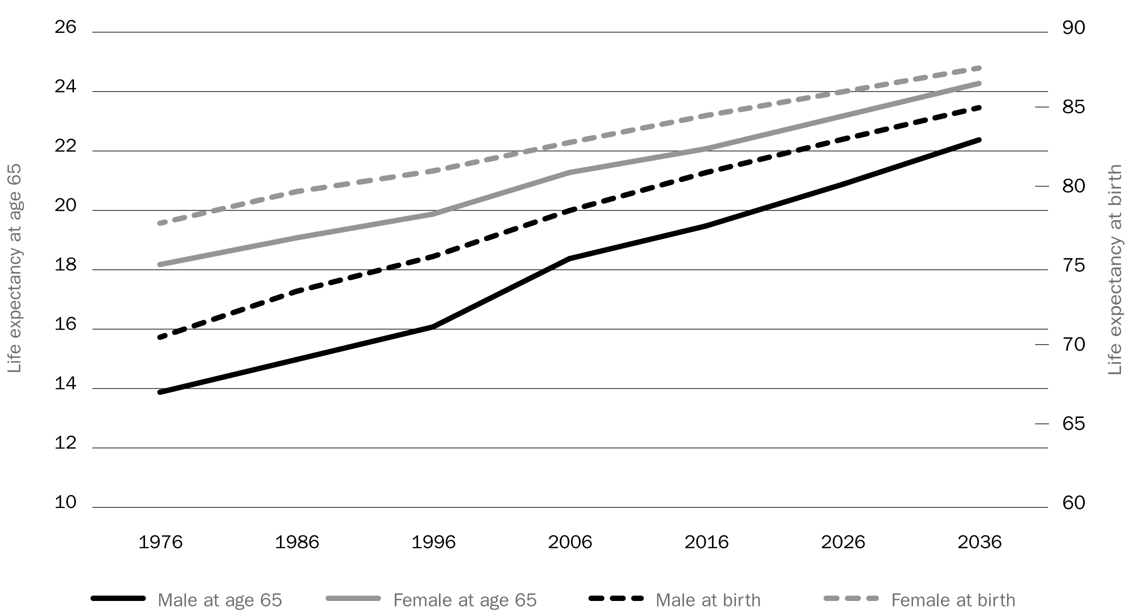
- Increasing life expectancy: Primarily as a result of advances in healthcare, life expectancy is increasing. According to Statistics Canada, the average life expectancy at birth for Canadians born during the three-year-period between 2005 and 2007 increased to 80.7 years. As recently as the 1995 to 1997 period, the average life expectancy for Canadians at birth was 78.4 years.

### LIFE EXPECTANCY IN CANADA AT BIRTH AND AT AGE 1




Source: Statistics Canada; Life expectancy at birth and at age 1, by sex, Canada (1920–1922 to 2005–2007)

### LIFE EXPECTANCY IN ONTARIO, 1976 TO 2036




Source: Statistics Canada, 1976–2006, and Ontario Ministry of Finance projections.

Ontario has one of the highest life expectancies in the developed world. As the chart above illustrates, females born in Ontario in 2006 can expect to live an average of 83.1 years and males born that same year, an average of 78.8 years. Since the late 1970s, average gains in life expectancy have been in the order of 0.17 year per annum for females and 0.27 year per annum for males. Furthermore, individuals that reach the age of 65 have an average life expectancy that extends well beyond the average life expectancy at birth of the overall population.

According to the Ontario Ministry of Finance, the number of seniors aged 65 and over is projected to more than double from 1.8 million, or 13.9% of Ontario's population, in 2010 to 4.1 million, or 23.4%, by 2036. The growth in the share and number of seniors will accelerate over the 2011–2031 period as baby boomers begin to turn age 65.

Up to the mid-1990s, annual gains in life expectancy were getting somewhat smaller and it was expected that future improvements would continue at this slowing pace. However, over the past decade, annual gains in life expectancy have picked up and appear to grow following a more linear trajectory. Future gains in life expectancy are projected to be concentrated at older ages and to be smaller for newborns.

- Increasing seniors' affluence: Seniors generally fund the costs of the seniors' living solution that best suits their needs through: selling their existing home; income generated from their savings and pensions; and/or financial support from family members.

  According to Care Planning Partners, a leading provider of market and financial consulting services to the seniors' housing and long-term care industries, 73.6% of Ontario seniors over the age of 75 own their homes mortgage-free. According to CMHC, the average value of a home in Ontario in December 2011 was just over $366 thousand, the second highest provincial average in Canada.

  According to Statistics Canada, the average, after-tax household income of a Canadian economic family with two members or more (defined as an economic family group of individuals sharing a common dwelling unit, who are related by blood, marriage, common-law relationships, or adoption) was $59,600 in 1990 (inflation adjusted to 2009 dollars), compared to $74,700 in 2009.

  Increases in net worth (largely as a result of the many seniors who now own their homes debt-free), combined with increased household incomes, allow seniors to afford a much higher quality housing product with greater amenities than at any time in the past. Seniors' housing is now more upscale and residential, compared to the institutional feel that previously characterized such facilities.

  In LTC residences, seniors can choose to live in private or semi-private accommodation that affords greater dignity for the resident receiving care and services, and available privacy for day-to-day living. This in turn can provide greater peace of mind for the resident's family members.

  RR and IL residences now feature one or two bedroom units, as opposed to the smaller, one-room studio-style units that were more common in the past. Further, many RR and IL residences now feature lifestyle amenities such as fitness centres, lounges, restaurants, spas, theatres, and wireless internet services, typically found in preferred hotels and condominiums.

- Changing family dynamics: With more and more families having both spouses working full-time outside of the home and changes in lifestyle reducing the ability of adult children to care for their aging parents, seniors' housing facilities are an attractive option. There is also an increasing demand for home healthcare services as wait-lists for medical services and emergency room wait-times increase.

- LTC provides a cost effective alternative: Rising healthcare costs have resulted in a reduction in the length of hospital stays and a greater demand for home healthcare services and, in turn, are a predominant factor in growing LTC wait-list numbers. This has resulted in LTC homes increasingly being filled by residents with higher care requirements, leading to higher occupancy levels in LTC homes. There are currently 77,500 LTC beds in Ontario and a wait list of more than 20,000 individuals. Many of the individuals currently on wait lists for LTC beds are occupying acute care beds in Ontario hospitals. According to the MOHLTC, the average cost for the Ontario government to fund an acute care hospital bed for a senior is approximately $1,000 a day, compared to approximately $150 a day in a LTC home.
- Recession stability: The LTC industry has historically been largely insulated from economic cycles. This can be attributed to several factors: (i) seniors are generally retired and receiving stable, fixed and predictable income from private and public pensions, RRSPs and other fixed income investment securities; (ii) demand for LTC housing is not usually discretionary but driven by need, which does not fluctuate during economic cycles; (iii) stability of tenure, as seniors, once having moved into a facility, are reluctant or unable to move to alternative accommodation; (iv) the continual increase in the demand for seniors' accommodation with skilled nursing due to the demographics of the aging population; and (v) a high level of government funding and subsidization of fees.

  The RR and IL industries are less insulated from economic cycles when compared to the LTC industry, as these accommodations are not government subsidized and therefore more susceptible to discretionary spending. However, certain of the same factors that support the recession stability of the LTC industry also apply to RRs and ILs such as: (i) seniors are generally retired and receiving stable, fixed and predictable income from private and public pensions, RRSPs and other fixed income investment securities; and (ii) stability of tenure, as seniors, once having moved into a facility, are reluctant or unable to move to alternative accommodation. For these reasons, management believes that the potential sensitivity impact of economic cycles on occupancy rates for RRs and ILs is minimal.

### LTC CHARACTERISTICS

LTC homes are social infrastructure assets as they provide essential health services. This sector can be distinguished from other sectors of the seniors' housing industry based on a number of factors, including the following:

- Provision of an essential service: The Ontario LTC sector provides an essential service to Ontario communities. LTC licensed homes generally provide 24-hour nursing support, daily assistance with personal care and supervision throughout the day to individuals who may otherwise require hospital care.
- Significant barriers to entry: Barriers to entry are both regulatory and operational. The LTC sector in the Province of Ontario is regulated by the MOHLTC, which requires that, in order to operate as an LTC home and to receive government funding, a home must be licensed or receive a letter of approval to operate from the MOHLTC. In considering whether it is in the public interest to grant a licence to operate an LTC home, the MOHLTC takes into account certain prescribed factors, including licensed bed capacity in the area, health facilities in the area other than LTC homes providing nursing care, the number of applicants for nursing care and available funds. In addition, LTC homes in the Province of Ontario must be built to specified design criteria and funding is tied to the level of delivery of mandated care services. These regulations create significant barriers to entry in the LTC sector and restrict the supply of beds. Currently, there is an almost universal restriction on the issuance of new licences in the Province of Ontario due to funding implications. There are also restrictions on the transfer or reissuance of licences whereby new industry entrants are heavily scrutinized and, conversely, experienced LTC operators with a sophisticated understanding of the regulatory landscape, such as Leisureworld, often gain an advantage as preferred purchasers whose wait time for approvals may be shortened. In addition to the regulatory barriers to entry, the successful operation of an LTC home demands a broad range of expertise, which creates additional barriers to entry. The operational skills required include management of healthcare operations, maintenance, marketing, community relationships, labour relations, government relations and financing. Larger operators may be better able to address these required skills through dedicated head office staff responsible for specific functions, the cost of which may be allocated across multiple homes.

- Sustainable competitive advantage: LTC homes have a sustainable competitive advantage over other sectors in the Ontario seniors' housing industry due to affordability for seniors and as a cost-effective alternative to Complex Continuing Care ("CCC"), or acute care hospital beds for eligible patients.
- Stability of revenues: LTC homes tend to enjoy predictable revenue for the following reasons: (i) a significant portion of revenues generated by LTC homes is received from MOHLTC funding; (ii) LTC homes are characterized by consistently high occupancy levels; (iii) there is a stable trend in escalation of payments; and (iv) revenue from preferred accommodation is available.

## LTC FUNDING MODEL

Ontario LTC homes are funded through a well-defined funding model. Licensed operators of Ontario LTC homes are entitled to operating subsidies (subject to annual reconciliation), as well as various capital renewal program payments. Provincial support for the Ontario LTC sector has been demonstrated by increased funding commitments to the sector. Operational funding of LTC homes in the Province of Ontario is currently paid monthly and is divided into three "envelopes." The three envelopes include Nursing and Personal Care ("NPC"), Programs and Support Services ("PSS") and Other Accommodation, which includes Raw Food. Total operational funding received by operators includes a provincial government component and a direct charge to residents in respect of accommodation services. Each envelope is structured as a fixed amount per resident per day, or "rate." If an LTC home's average annual occupancy meets or exceeds 97%, it is the MOHLTC's policy to provide funding based on 100% occupancy. Effective for the 2011 fiscal year, the MOHLTC introduced an interim policy for homes with occupancy rates above 85% and below 97% to provide funding based on actual occupancy plus 3%. Previously, if an LTC home's average annual occupancy level was below 97%, the MOHLTC provided funding based on actual occupancy levels.

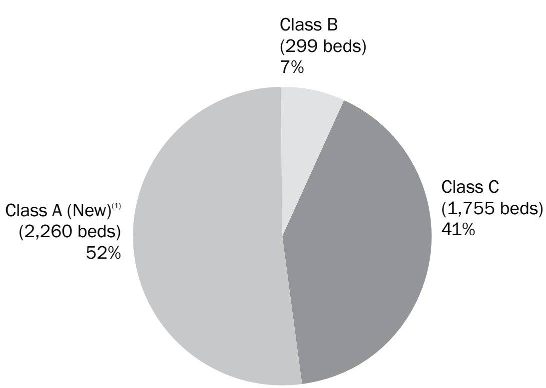
The MOHLTC categorizes and provides structural compliance and capital funding for homes according to four bed classes: Class A, which includes New, Class B, Class C and Class D. Capital funding is available to operators of LTC homes through Structural Compliance Premiums, Capital Cost Funding for New beds, Capital Cost Funding for Class B and C beds, Accreditation and several other revenue sources.

## BUSINESS OVERVIEW

### LTC homes

Leisureworld's portfolio is comprised largely of New homes within the Class A category, which represent approximately 52% of Leisureworld's beds. Class B and C homes represent 7% and 41% of the portfolio, respectively. In addition, Leisureworld is well positioned to capitalize on the Capital Renewal Initiatives, which will provide funding to upgrade Class B and C homes.

## SUMMARY OF LTC BEDS BY CLASS

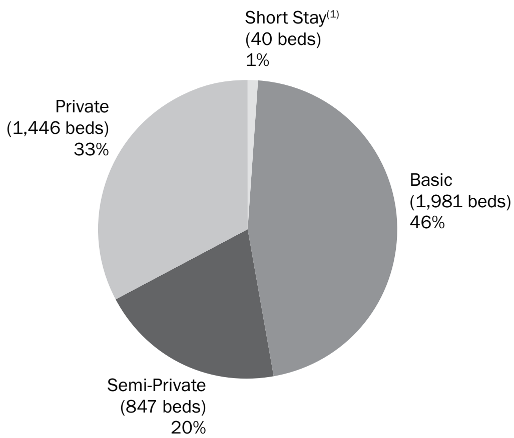



Note:

(1) All of Leisureworld's Class A homes are designated New, meeting or exceeding the MOHLTC's most recent (1998) design standards and qualifying for additional capital funding of $10.35 per day, per bed.

A significant proportion of Leisureworld's LTC beds are designated as preferred accommodation with approximately 53% of beds designated as private or semi-private accommodation. Approximately 4% of the revenues and 23% of the Net Operating Income ("NOI") (see "Non-IFRS performance measures") from Leisureworld's LTC operations are generated from charging residents the regulated premium of $18.00 and $8.00 per day per bed for private and semi-private accommodation, respectively.

### SUMMARY OF LTC BEDS BY ACCOMMODATION TYPE




Note:

(1) Short stay and convalescent care beds are reserved for people requiring stays in a LTC home of less than 30 and 90 days, respectively. Short stay beds are designed to provide home caregivers with relief from their caregiving duties on a periodic basis. Convalescent care beds are typically used to provide resident support following a hospital stay. Short stay beds are funded at 100% occupancy regardless of actual occupancy and convalescent care beds are funded at 100% occupancy, provided average annual occupancy meets or exceeds 80%. In addition, convalescent care beds earn additional funding as a result of the higher level of care required.

#### Retirement and independent living residences

Canada's 75-plus age cohort is entering a period of unprecedented growth, and if current demand levels for RR and IL residences remain constant, management believes Canada's current RR and IL capacity will not be able to meet future demand. Further, given the increasing affluence and evolving lifestyle expectations of Canadian seniors, management believes new opportunities are emerging to meet the preferences of this burgeoning demographic group. Affluent seniors who are in relatively good health, but prefer ready access to care and services in a community setting, are becoming increasingly discerning about the lifestyle options RR and IL operators provide. For instance, one to two bedroom living quarters are now preferred to single-room studio units that were more prevalent in the past. Further, amenities such as fitness centres, lounges, restaurants, spas, theatres, and wireless internet services, typically found in preferred hotels and condominiums, are also attractive. The provision of these "five star" luxury features and amenities enable RR and IL operators to optimize rental or lease rates and thereby realize superior operating margins to those that can be achieved via government subsidized seniors' housing. In addition, affluent seniors also appreciate the availability of à-la-carte services, such as chauffeured town cars or shuttle vans for day trips, dog walking services, beauty salons, cooking classes, or gourmet prepared meals, which enable operators to further enhance margins.

Leisureworld owns and operates a RR consisting of 29 suites that adjoins the Muskoka LTC home, and one IL residence comprising 53 apartments that is attached to the Scarborough LTC home. These two homes as at the end of the year have a combined occupancy of approximately 90% and are integral to seniors' services provided within their local communities. On April 27, 2011, Leisureworld acquired two additional RRs comprising 294 suites located in Kingston and Kanata, Ontario. These residences are new luxury retirement living properties featuring top quality amenities and services. Leisureworld is now marketing these properties under the Company's 'The Royale' brand. As new properties, both residences are currently in the lease-up period. Occupancy rates as at December 31, 2011 were 64.7% at Kingston and 60.1% at Kanata. During the quarter, both the Kingston and Kanata properties realized 22 net new resident move-ins. Due to seasonality, we have encountered several discharges in the first quarter of 2012, which is not unexpected.

As part of the total purchase consideration for the Kingston and Kanata RRs, Leisureworld put in place a $5.5 million three-year income support agreement with the vendor, to be held in escrow as an income guarantee to supplement cash flow during the period that the residences are being leased-up. As at December 31, 2011, the Company has drawn down $3.1 million of the income support funds. Leisureworld's RRs will have to comply with the requirements of the Retirement Homes Act, as the regulations are phased in over time.

### Preferred Health Care Services

PHCS offers home care, education and training, and relief staffing services. These services either complement or support the core nursing home operations of Leisureworld. PHCS effectively broadens Leisureworld's presence across the continuum of care. PHCS has been providing professional nursing and personal support services in the community and LTC homes since 1987. Employees of PHCS include registered nurses, registered practical nurses, foot care nurses, companions and personal support workers who work on a permanent full-time, part-time or elect-to-work basis. Elect-to-work employees are not guaranteed any minimum amount of work. Employees are non-unionized and salaries are dictated by the market.

## KEY PERFORMANCE DRIVERS

There are a number of factors that drive the performance of Leisureworld:

### Government funding for LTC facilities ensures stability of cash flow

Ontario's LTC sector is regulated by the MOHLTC according to a defined funding model. This model contributes to the stability of Leisureworld's cash flow. Operational funding, paid monthly, is divided into three envelopes: NPC; PSS; and Other Accommodation. Approximately 70% of revenue from Leisureworld's LTC homes is received from the MOHLTC. Over the past 10 years, government funding of Leisureworld's LTC homes has increased in excess of the Consumer Price Index. Leisureworld also receives capital cost funding of $10.35 per bed, per day from the MOHLTC for Class A homes, as well as payments from residents for both basic and preferred accommodation. Leisureworld also receives structural compliance premiums from the MOHLTC, of $2.50 and $1.00, on a per resident per day basis, for Class B and C homes, respectively. Additionally, the MOHLTC provides funding to LTC homes that have been accredited and reimburses up to 85% of property and capital tax costs.

In 2007, the MOHLTC committed to a capital renewal program that will provide additional funding to operators to upgrade the province's 35,000 Class B and C homes to Class A standards, thereby improving the overall quality and comfort of accommodation available to residents. In April 2009, the MOHLTC published an updated design manual and policy for funding construction costs for the redevelopment of Class B and C LTC homes. The funding for these redevelopment projects will be in the form of a 25-year commitment from the MOHLTC, to pay a specific amount per bed, per day, which depends on the actual construction cost and also the building's compliance with Leadership in Energy and Environmental Design ("LEED") design standards. Redevelopment of Leisureworld's Class C homes is expected to occur under this program in the years ahead, as the capital reimbursement is defined.

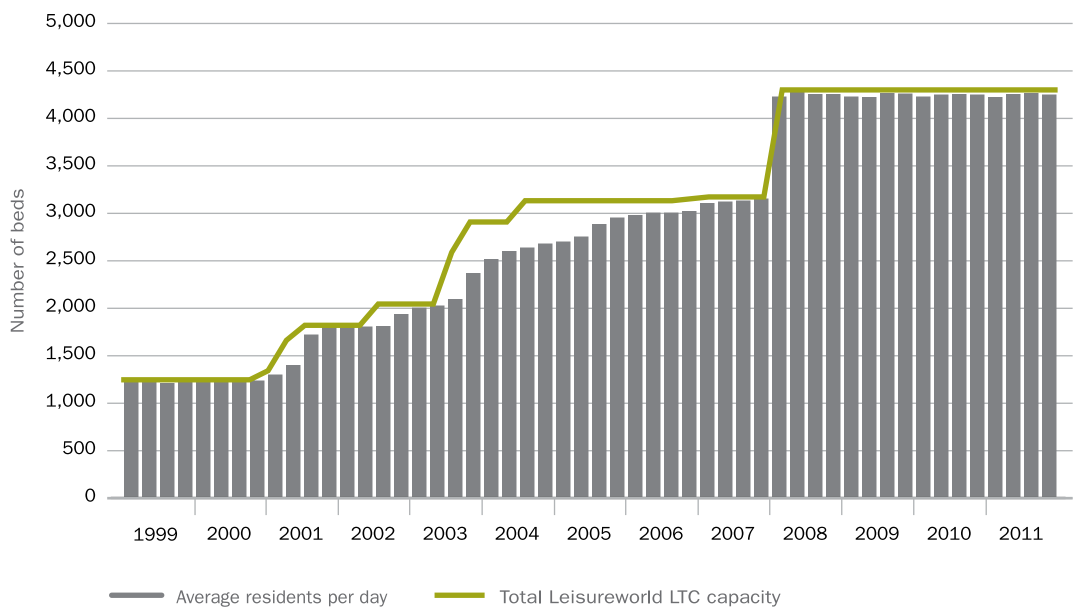
PHCS provides home care services that help individuals remain independent and active in their homes. Funding for such services is provided by CCAC's. CCAC's were created by the MOHLTC partially to administer publicly funded home care in the Province of Ontario. PHCS holds three CCAC contracts.

### Occupancy levels enhance cash flow

Occupancy is a key driver of Leisureworld's performance. An LTC home that meets or exceeds 97% annual average occupancy receives funding from the MOHLTC based on 100% occupancy. Effective for the 2011 fiscal year, the MOHLTC introduced an interim policy for homes with occupancy rates above 85% and below 97% to provide funding based on actual occupancy plus 3%. Leisureworld has a strong record of maximizing occupancy. In addition, the supply of LTC beds is controlled and regulated by the MOHLTC, which ensures barriers to entry. For the quarter and year-to-date period ended December 31, 2011, Leisureworld's average occupancy for LTC homes was 98.6% and 98.5%, respectively (2010 – 98.6% and 98.5%, respectively).

In addition, the demand for LTC homes is dictated by a need for care, driven by demographic trends rather than changes in the economy. According to the Ontario Ministry of Finance, the number of people aged 65 and over is projected to more than double from 1.8 million, or 13.9% of Ontario's population, in 2010 to 4.1 million, or 23.4%, by 2036. The growth in the share and number of seniors will accelerate over the 2011–2035 period as baby boomers begin to turn age 65.

### LTC OCCUPANCY TRACK RECORD[1]




Note:

(1) Includes only LTC beds.

Leisureworld's RR that adjoins its Muskoka LTC home, and its IL attached to its Scarborough LTC home, have a combined average occupancy for the quarter and year-to-date period ended December 31, 2011 of approximately 90%, and are integral to seniors' services provided within their local communities. For the quarter and year ended December 31, 2011, the two acquired properties in Kingston and Kanata have combined average occupancy rates of 60.1% and 53.6%, respectively. For Kingston and Kanata, management is targeting a net new average move-in rate of 2.5 per property per month, which will result in achieved occupancy exceeding 90% during the second half of 2013.

#### Optimization of private accommodation mix increases operating profitability

An LTC home that provides basic accommodation for at least 40% of residents may offer the remaining residents private accommodation at a regulated premium. The LTC home operator retains the premiums collected for such accommodation, which typically increases revenue and enhances profitability. The premium for a private room is currently $18 per day. Leisureworld has approximately 33.5% of the beds designated as private accommodation. Private bed average total occupancy for the quarter and year-to-date periods ended December 31, 2011 was 97.1% and 96.7%, respectively (2010 – 96.7% and 97.1%, respectively).

#### Disciplined cost management is key to operating profitability

Leisureworld enjoys economies of scale in areas such as hiring, purchasing and administration for its LTC homes. Long-term care operators in Ontario receive funding from the government. Operators must return any funding that is not spent for the NPC, PSS, and raw food envelopes to the government; however, spending in excess of the government funding is paid by the LTC operator. The Company is able to leverage many of these same corporate costs in operating its RR and IL properties. Leisureworld manages costs prudently to ensure it continues to provide quality accommodation and services, while maximizing operating profit.

### Ensuring high-quality care and services to all residents

A culture of quality is fostered by a corporate team that measures, monitors and audits Leisureworld's performance in care and services. Engagement with management and staff at all levels, through discussion and disseminating reports, analysis and recommendations, is an ongoing process. The outcome of these encounters is also connected to establishing best practices, revisions to benchmarks and is used to develop training and educational initiatives.

### Providing professional on-site administration of well-operated Leisureworld homes

Each home has its own on-site management team that is supported through regional and corporate staff who have areas of more focused expertise. Management of each Leisureworld home is supported by networking with other homes through internal conferences, home comparative management reports and involvement in project teams.

### Ensuring continued maintenance and upgrade of properties

Capital budgets, operational reviews and equipment/building service contracts are used by management in the planning and monitoring of Leisureworld's physical assets. Leisureworld has established an active, ongoing maintenance approach, which helps ensure appropriate preventative maintenance and that the Leisureworld homes operate efficiently and competitively.

## GROWTH STRATEGIES OF LEISUREWORLD SENIOR CARE CORPORATION

Management has identified both internal and external growth opportunities. Organic growth opportunities include project development under the Capital Renewal Initiatives, as well as an increase in the number of home healthcare contracts. External growth strategies include LTC, RR, IL and home healthcare acquisitions, expansion across the continuum of care, and geographic extension.

### Organic

Leisureworld anticipates participating in the MOHLTC's Capital Renewal Initiatives, under which 12 Class B and Class C LTC homes would be eligible for refurbishment. This strategy includes both the downsizing and retrofitting of certain of its homes as well as new home construction. Ultimately, the program is expected to extend licence terms at newly developed homes and increase preferred bed revenues. In addition, Leisureworld's PHCS business stands to benefit from the stated intention by the Government of Ontario to increase investment in community based services, which includes home healthcare services. As a result of the government initiative, management expects to obtain additional home healthcare contracts, which will ultimately result in PHCS becoming a larger participant in this sector.

### External

Management believes a large number of LTC acquisition targets exist as a result of the fragmented nature of the LTC industry. Additionally, Leisureworld will consider older LTC homes with limited redevelopment opportunities and implement the transportation of licensed capacity from those homes to Leisureworld's existing portfolio. Opportunities also exist for Leisureworld to expand in the RR and IL segment of senior housing through acquisition and development. Finally, management anticipates opportunities to diversify Leisureworld's portfolio into other regions of Canada through accretive acquisitions.

## NON-IFRS PERFORMANCE MEASURES

Net operating income (loss) ("NOI"), funds from operations ("FFO"), and adjusted funds from operations ("AFFO") are not measures recognized under IFRS and do not have standardized meanings prescribed by IFRS. NOI, FFO and AFFO are supplemental measures of a company's performance and Leisureworld believes that NOI, FFO and AFFO are relevant measures of its ability to pay dividends on the Company's common shares. The IFRS measurement most directly comparable to NOI, FFO and AFFO is net income (loss). See "Business Performance" for a reconciliation of NOI, FFO and AFFO to net income (loss).

“NOI” is defined as net income (loss) computed in accordance with IFRS, excluding gains or losses from the sale of depreciable real estate and extraordinary items, but before the provision (recovery) of income taxes, amortization, net finance charges, loss (gain) on interest rate swap contracts, and administrative expenses.

“FFO” is defined as NOI plus accretion interest on construction funding receivable and transaction costs, less cash interest, current income taxes, and administrative expenses. Other adjustments may be made to FFO as determined by the Company at its discretion. In the opinion of management, the use of FFO, combined with the required primary IFRS presentations, is fundamentally beneficial to the users of the financial information, and improves their understanding of the operating results of Leisureworld. Management generally considers FFO to be a useful measure for reviewing Leisureworld’s operating and financial performance because, by excluding real estate asset amortization (which can vary among owners of identical assets in similar condition based on historical cost accounting and useful life estimates), FFO can help users of the financial information compare the operating performance of Leisureworld’s real estate portfolio between financial reporting periods.

“AFFO” is defined as FFO plus the principal portion of construction funding receivables and amounts received from income guarantees less maintenance capital expenditures (“capex”). Other adjustments may be made to AFFO as determined by the Company at its discretion. Management believes AFFO is useful in the assessment of Leisureworld’s operating performance for valuation purposes, and is also a relevant measure of the ability of Leisureworld to earn cash and pay dividends to shareholders.

NOI, FFO and AFFO should not be construed as alternatives to net income (loss) or cash flow from operating activities determined in accordance with IFRS as indicators of Leisureworld’s performance. Leisureworld’s method of calculating NOI, FFO and AFFO may differ from other issuers’ methods and accordingly, these measures may not be comparable to measures used by other issuers.

## BUSINESS PERFORMANCE

For the quarter ended December 31, 2011, NOI increased by $1,212 or 11.2% to $12,067. The LTC portfolio contributed $215 of increased NOI, primarily due to greater government funding and cost constraint measures across the business segment. The Royale LP (“Royale”) retirement properties contributed $922 of NOI, and PHCS’s NOI increased by $128 due to an increase in personal support contract volumes.

For the year ended December 31, 2011, NOI of $45,939 increased $3,926 or 9.3% over the comparable period. The improvement was primarily due to increased government funding and cost constraint measures across the LTC portfolio resulting in an increase in NOI of $1,896, Royale retirement properties provided an additional $1,613 of increased NOI and PHCS contributed $471 to NOI as a result of increased personal support contract volumes.

FFO for the quarter was $4,760, an increase of $296 or 6.6%. The increase was primarily the result of increased NOI of $1,212 and increased add-back for transaction costs of $1,621, offset by $1,646 of increased administrative expenses. The transaction costs in the period reflect the inclusion of land transfer taxes of $1,130, which was previously capitalized, associated with the Royale transactions to align with the industry’s treatment when accounting for business combinations. The higher administrative expenses were primarily due to higher acquisition related and consulting costs, as well as people related costs compared to the same period in the previous year. Net finance charges also increased by $550, primarily as a result of the credit facility (“Bridge Loan”) related to the acquisition of the retirement properties in Kingston and Kanata.

For the year, FFO was $19,581 compared to $17,144 in the prior year. The increase of $2,437, or 14.2%, primarily related to improved NOI of $3,926, the increased add-back for transaction related costs of $2,430, which includes the land transfer tax as discussed above, and lower income tax expenses of $737 compared to the prior year, which related to an income tax book to filing adjustment of $739. This was partly offset by higher administrative expenses of $3,394, as a result of public company expenses and transaction related costs of $2,845, as well as higher people related costs of $1,073, partly offset by lower consulting costs of $367.

AFFO for the quarter increased to $6,754 from $5,030. The increase of $1,724 or 34.3%, was primarily attributable to the $901 drawdown of the income support funds in conjunction with the lease-up of the acquired retirement properties, improved FFO of $296 and lower maintenance capex of $168.

AFFO for the year was $26,580, compared to $20,580 in the prior year. The increase of $6,000, or 29.2%, was primarily due to higher FFO of $2,437, the $3,105 drawdown of the income support funds in conjunction with the lease-up of the acquired retirement properties, lower maintenance capex of $536, partially related to MOHLTC funding initiatives announced late in the year, and increased construction funding principal of $513. This was partly offset by the income tax book to filing adjustment of $739.

## NET OPERATING INCOME

| Thousands of dollars | **LSCC Quarter Ended December 31, 2011** | LSCC Quarter Ended December 31, 2010 | **LSCC Year Ended December 31, 2011** | LSCC[1] and LSCLP Year Ended December 31, 2010 |
|---|---|---|---|---|
| **Net loss** | **(3,344)** | (2,268) | **(11,977)** | (8,246) |
| Recovery of income taxes | **(1,140)** | (846) | **(5,570)** | (2,744) |
| **Loss before income taxes** | **(4,484)** | (3,114) | **(17,547)** | (10,990) |
| Depreciation and amortization | **8,030** | 7,633 | **32,666** | 27,947 |
| Net finance charges | **4,175** | 3,301 | **15,706** | 13,785 |
| Loss (gain) on interest rate swap contracts | **(336)** | (79) | **684** | (183) |
| **Income from Operations Before the Undernoted** | **7,385** | 7,741 | **31,509** | 30,559 |
| Administrative expenses | **4,682** | 3,114 | **14,430** | 11,454 |
| **Net Operating Income (NOI)** | **12,067** | 10,855 | **45,939** | 42,013 |

Notes:

(1) The Year Ended December 31, 2010 presentation is the total of LSCLP results of operations pre-initial public offering for the period from January 1, 2010 to March 22, 2010 added to the results of the Company for the post-initial public offering period of March 23, 2010 to December 31, 2010.

## FUNDS FROM OPERATIONS AND ADJUSTED FUNDS FROM OPERATIONS

| Thousands of dollars, except share and per share data | **LSCC Quarter Ended December 31, 2011** | LSCC Quarter Ended December 31, 2010 | **LSCC Year Ended December 31, 2011** | LSCC[1] and LSCLP Year Ended December 31, 2010 |
|---|---|---|---|---|
| **Net Operating Income (NOI)** | **12,067** | 10,855 | **45,939** | 42,013 |
| Interest income on construction funding receivable | **753** | 1,017 | **3,111** | 3,624 |
| Net finance charges[2] | **(4,360)** | (3,810) | **(16,615)** | (15,866) |
| Current income taxes[3] | **(704)** | (627) | **(1,185)** | (1,922) |
| Administrative expenses[4] | **(4,626)** | (2,980) | **(14,134)** | (10,740) |
| Transaction costs[5] | **1,630** | 9 | **2,465** | 35 |
| **Funds from Operations (FFO)** | **4,760** | 4,464 | **19,581** | 17,144 |
| Income tax book to filing adjustment | **–** | – | **(739)** | – |
| HRIS expense | **47** | (48) | **76** | (72) |
| Income support | **901** | – | **3,105** | – |
| Construction funding principal | **1,380** | 1,116 | **5,421** | 4,908 |
| Maintenance capex[6] | **(334)** | (502) | **(864)** | (1,400) |
| **Adjusted Funds from Operations (AFFO)** | **6,754** | 5,030 | **26,580** | 20,580 |
| **Basic FFO per share** | **$0.1949** | $0.2231 | **$0.8504** | n/a |
| **Basic AFFO per share** | **$0.2765** | $0.2514 | **$1.1544** | n/a |
| **Weighted average common shares outstanding – Basic**[7] | **24,423,483** | 20,008,649 | **23,024,705** | n/a |
| **Diluted FFO per share** | **$0.1944** | $0.2220 | **$0.8477** | n/a |
| **Diluted AFFO per share** | **$0.2758** | $0.2501 | **$1.1508** | n/a |
| **Weighted average common shares outstanding – Diluted**[7] | **24,490,149** | 20,108,649 | **23,097,673** | n/a |

Notes:

(1) The Year Ended December 31, 2010 presentation is the total of LSCLP results of operations pre-initial public offering for the period from January 1, 2010 to March 22, 2010 added to the results of the Company for the post-initial public offering period of March 23, 2010 to December 31, 2010.

(2) Net finance charges excluding non-cash interest expense on debentures, construction funding interest income, and non-cash interest income on annuity.

(3) LSCLP was not a taxable entity.

(4) Administrative expenses have been decreased by $56, $134, $296, and $714 respectively for share-based compensation expense related to stock issued to senior management in relation to the IPO, the effect being a reduction in proceeds to the seller.

(5) Transaction costs restated for the Quarter Ended March 31, 2011 due to the change from an AFFO adjustment to an FFO adjustment.

(6) Maintenance Capex has been decreased by $149, $205, $710, and $1,597 respectively for capital expenditures related to the implementation of the new HRIS.

(7) Weighted average common shares outstanding are calculated based on the period of time the shares have been outstanding. Prior MD&A disclosures calculated the share weighting based on months of dividend eligibility.

## QUARTERLY FINANCIAL INFORMATION

| Thousands of dollars, except per share data | LSCC Q4 2011 | LSCC Q3 2011 | LSCC Q2 2011 | LSCC Q1 2011 | LSCC Q4 2010 | LSCC Q3 2010 | LSCC Q2 2010 | LSCC and[1] LSCLP Q1 2010 |
|---|---|---|---|---|---|---|---|---|
| Revenue | **79,028** | **73,310** | **70,029** | **67,740** | 71,589 | 68,824 | 66,785 | 65,152 |
| Operating expenses (excluding depreciation and amortization) | **66,961** | **60,952** | **58,621** | **57,634** | 60,734 | 58,319 | 55,878 | 55,406 |
| Administrative expenses (excluding loss (gain) on swap) | **4,682** | **3,364** | **3,192** | **3,192** | 3,114 | 2,493 | 2,962 | 2,885 |
| Income from operations before the undernoted | **7,385** | **8,994** | **8,216** | **6,914** | 7,741 | 8,012 | 7,945 | 6,861 |
| Net loss | **(3,344)** | **(3,320)** | **(2,449)** | **(2,864)** | (2,268) | (2,291) | (2,214) | (1,473) |
| Per share and diluted per share | **(0.14)** | **(0.14)** | **(0.11)** | **(0.14)** | (0.11) | (0.11) | (0.11) | N/A |
| Dividends declared[2] | **5,202** | **5,202** | **5,202** | **4,271** | 4,271 | 4,271 | 4,685 | N/A |
| Per share and diluted per share | **0.21** | **0.21** | **0.21** | **0.21** | 0.21 | 0.21 | 0.23 | N/A |
| AFFO | **6,754** | **7,657** | **7,007** | **5,162** | 5,030 | 5,533 | 5,538 | 4,479 |
| Per share – basic[3] | **0.28** | **0.31** | **0.30** | **0.26** | 0.25 | 0.28 | 0.28 | N/A |
| Per share – diluted[3] | **0.28** | **0.31** | **0.30** | **0.26** | 0.25 | 0.28 | 0.28 | N/A |

Notes:

(1) The Year Ended December 31, 2010 presentation is the total of LSCLP results of operations pre-initial public offering for the period from January 1, 2010 to March 22, 2010 combined with the results of the Company for the post-initial public offering period of March 23, 2010 to December 31, 2010.

(2) All dividends paid by the Company, unless otherwise indicated, are designated as eligible dividends for Canadian tax purposes in accordance with subsection 89(14) of the Income Tax Act (Canada), and any applicable corresponding provincial and territorial provisions.

(3) AFFO per share calculations are based on weighted averate shares outstanding, which are calculated based on the period of time the shares have been outstanding. Prior MD&A disclosures calculated the share weighting based on months of dividend eligibility.

The quarterly results of the Company are subject to various factors including, but not limited to, timing of acquisitions, seasonality of utility expenses, the timing of government funding rate increases and the timing of revenue recognition to match spending within the flow-through envelopes.

Following the Company's conversion to IFRS, administrative expenses for the quarters ended December 31, 2011, September 30, 2011, June 30, 2011, March 31, 2011, December 31, 2010 and September 30, 2010, include transaction costs of $1,630, $131, $263, $449, $9 and $26, respectively.

As a result of the IPO in the quarter ended March 31, 2010, the Company's administrative expenses increased.

A discussion of the quarter ended December 31, 2011 results compared to the same period in the prior year is provided under the section "Selected Consolidated Financial and Operating Information".

## SELECTED CONSOLIDATED FINANCIAL AND OPERATING INFORMATION

Thousands of dollars, unless otherwise noted

| | **LSCC Quarter Ended December 31, 2011** | LSCC Quarter Ended December 31, 2010 | **LSCC Year Ended December 31, 2011** | LSCLP[1] and LSCC Year Ended December 31, 2010 |
|---|---|---|---|---|
| **Revenue** | **79,028** | 71,589 | **290,107** | 272,350 |
| **Expenses** | | | | |
| Operating expenses[2] | **66,961** | 60,734 | **244,168** | 230,337 |
| Administrative expenses[3] | **4,682** | 3,114 | **14,430** | 11,454 |
| | **71,643** | 63,848 | **258,598** | 241,791 |
| **Income from operations before the undernoted** | **7,385** | 7,741 | **31,509** | 30,559 |
| **Other expenses** | | | | |
| Depreciation and amortization | **8,030** | 7,633 | **32,666** | 27,947 |
| Net finance charges | **4,175** | 3,301 | **15,706** | 13,785 |
| Loss (gain) on interest rate swap contract | **(336)** | (79) | **684** | (183) |
| **Total other expenses** | **11,869** | 10,855 | **49,056** | 41,549 |
| **Loss before income taxes** | **(4,484)** | (3,114) | **(17,547)** | (10,990) |
| **Provision for (recovery of) income taxes** | | | | |
| Current | **704** | 627 | **1,185** | 1,922 |
| Deferred | **(1,844)** | (1,473) | **(6,755)** | (4,666) |
| | **(1,140)** | (846) | **(5,570)** | (2,744) |
| **Net loss** | **(3,344)** | (2,268) | **(11,977)** | (8,246) |
| **Total assets** | **644,551** | 578,421 | **644,551** | 578,421 |
| **Long-term debt** | **355,399** | 298,496 | **355,399** | 298,496 |
| **Average occupancy** | | | | |
| **Long-term care** | **98.6%** | 98.6% | **98.5%** | 98.5% |
| **Long-term care – private accomodations** | **97.1%** | 96.7% | **96.7%** | 97.1% |
| **Retirement and independent living**[4] | **66.7%** | 95.4% | **64.2%** | 94.3% |

Notes:

(1) The Year Ended December 31, 2010 presentation is the total of LSCLP results of operations pre-initial public offering for the period from January 1, 2010 to March 22, 2010 added to the results of the Company for the post-initial public offering period.

(2) Operating expenses excluding depreciation and amortization.

(3) Administrative expenses excluding loss (gain) on interest rate swap contracts.

(4) The 2011 retirement and independent living occupancy rates include the addition of the Kingston and Kanata properties as of April 27, 2011, which were acquired in lease-up and not yet at stabilized occupancy. The 2010 occupancy rates only include the Muskoka and Scarborough properties.

### Revenue

For the quarter ended December 31, 2011, Leisureworld generated revenue of $79,028 compared to $71,589 in 2010, representing an increase of $7,439 or 10.4%. LTC accounted for $4,363 of the increase, primarily due to a year over year government funding rate increase of approximately 3.9% or $2,180 and incremental funding of approximately $477 related to the case mix index adjustment. As well, the increase includes $1,524 of funding due to the timing of revenue recognition to match spending under the flow-through funding envelopes and incremental special initiative funding of $363. The increase was partly offset by $296 of unfavourable prior period government funding adjustment compared to a $464 favourable adjustment in the comparable quarter. Retirement revenue accounted for $2,428 of the increase due primarily to the operations of the two retirement residences acquired on April 27, 2011. PHCS's external revenue increased by $648, primarily attributable to an increase in personal support contract volumes.

For the year ended December 31, 2011, total revenue was $290,107 compared to $272,350 in the prior year, an increase of $17,757 or 6.5%. LTC accounted for $10,345 of the increase which resulted from a 3.7% year-to-date rate increase in government funding of $8,279, incremental funding of approximately $973 related to the case mix index adjustment, additional revenues of $571 for incremental special initiative funding of compliance costs associated with new regulations. Other increases include capital and equipment funding of $1,249. This was partly offset by $1,071 due to timing of revenue recognition to match spending under the flow-through funding envelopes and unfavourable prior period government funding adjustments in the current year of $297 compared to $315 of favourable adjustments in the comparable year. Revenue from the operations of the Royale retirement residences contributed $5,883 of increased revenue. PHCS's external revenues increased by $1,572, as a result of a higher volume of personal support contracts.

### Operating expenses

Operating expenses for the quarter ended December 31, 2011 were $66,961, which was $6,227 or 10.3% higher than the previous year. LTC expenditures increased by $4,150 compared to the prior year. The increase is attributable to expenses incurred as a result of the increased funding of $4,405, higher dietary service costs of $397 following the implementation of increased regulatory requirements and associated funding and higher property maintenance costs of $191. This was partly offset by lower property administration costs of $892. Retirement-related operating expenses for the quarter increased by $1,559, attributable to the operations of the two recently acquired retirement residences. During the quarter ended December 31, 2011, PHCS's operating expenses increased by $619, primarily as a result of a higher volume of personal support contracts.

For the year ended December 31, 2011, operating expenses of $244,168 increased by $13,831 or 6.0% over the prior year. Higher expenses resulted from $8,450 of increased LTC operating costs, of which $8,700 related to increased government funding in the flow-through envelopes, including special initiative funding. As well, dietary service costs increased by $1,195 following the implementation of increased regulatory requirements and associated funding. These increases were partly offset by lower property administration expenses of $1,045. The increases in operating expenses also included the impact of HST, which became effective on July 1, 2010. The recently acquired retirement residences increased operating expenses by $4,270. For the year, PHCS's expenses increased by $1,246, which primarily resulted from increases in the volume of personal support contracts.

### Administrative expenses

Administrative expenses for the quarter ended December 31, 2011 were $4,682, representing an increase of $1,568 from the corresponding quarter in 2010. The increase was primarily related to higher transaction related costs of $1,621 and increased people related costs of $182. The transaction costs in the period reflect the inclusion of land transfer taxes of $1,130, which was previously capitalized, associated with the Royale transaction, to align with the industry's treatment when accounting for business combinations. This was partly offset by lower consulting costs in the quarter of approximately $129.

For the year, administrative expenses increased by $2,976 to $14,430. The increase is due to higher transaction related costs of $2,451, higher people related costs of $619, and public company costs of $430. The transaction costs were impacted by the inclusion of land transfer taxes as mentioned in the quarters discussion. This was partly offset by lower consulting fees of $367.

### Depreciation and amortization

For the quarter ended December 31, 2011, depreciation and amortization increased by $397 to $8,030. The increase was primarily attributed to higher depreciation related to the acquired retirement portfolio of $578 for the property and equipment. This was partly offset by a year-to-date reversal of $188 on the amortization of resident relationships relating to the Royale properties due to the finalization of the purchase price allocation and the associated impact on lowering the value ascribed to the intangible asset. The main components of depreciation and amortization charges are property and equipment, $4,663, resident relationships, $3,088, and service contracts, $257.

For the year, depreciation and amortization expense was $32,666, an increase of $4,719 over the prior year. The increase was primarily due to higher amortization of resident relationships of $3,585 and service contracts of $232. As well as, increased depreciation of property and equipment of $905. The main components of depreciation and amortization charges are property and equipment, $17,378, resident relationships, $14,159, and service contracts, $1,027.

### Net finance charges

For the quarter ended December 31, 2011, net finance charges totalled $4,175, which was an $874 increase from the quarter ended December 31, 2010. The increase primarily resulted from higher interest expense on long- term debt of $555 due to the incremental interest paid on the Bridge Loan, including the interest rate swap contract related to the Bridge Loan, and lower non-cash interest income of $264 related to the construction funding receivable.

For the year, net finance charges totalled $15,706, representing a $1,921 increase over the prior year. The increase primarily resulted from incremental interest expense of $1,507 from the Bridge Loan used to acquire the Royale retirement properties, including the interest rate swap contract related to the Bridge Loan, higher accretion of the fair value increment on the long-term debt of $446, and lower non-cash interest income of $513 related to the construction funding receivable. This was partly offset by lower interest on the term loan of $568 that was settled in the prior year.

### Income taxes

Current income taxes have been calculated at the combined corporate tax rate of 28.25% based on taxable income for the quarter. The income tax recovery for the quarter ended December 31, 2011 was $1,140, an increase of $294 compared to the prior year. The change was due to an increased tax provision of $77 partly offset by deferred income tax recovery of $371 recorded in the quarter related to timing of recognition of temporary differences primarily attributable to the treatment of the land transfer tax as an accounting expense.

For the year, the net tax recovery was $5,570 compared to $2,744 for the prior year. The increase in recovery is due to an income tax book to filing adjustment in the second quarter of $739 related to the prior tax year, and an increase in the deferred income tax recovery of $2,089 related to temporary differences arising from the depreciation and amortization. As well, the prior year was only subject to tax on the portion of the net loss after the IPO on March 23, 2010.

### Net loss

For the quarter ended December 31, 2011, the net loss was $3,344 compared to $2,268 for the prior year. The higher net loss was the result of increased net finance charges, higher depreciation and amortization expense and lower income from operations before the undernoted. This was partly offset by the increased tax recovery for the quarter and the larger gain on the mark-to-market adjustment on the swap contracts.

For the year, the net loss was $11,977 compared to $8,246. The higher net loss was the result of increased depreciation and amortization expense, net finance charges, and a comparative loss on the interest rate swap contracts, partly offset by the higher tax recovery and improved income from operations before the undernoted.

## LIQUIDITY AND CAPITAL RESOURCES

Leisureworld reported a cash and cash equivalents balance of $21,921 as at December 31, 2011. The changes in cash and cash equivalents for the quarter and periods ended December 31, 2011 and 2010 are as follows:

| | **Quarter Ended December 31, 2011** | Quarter Ended December 31, 2010 | **Year Ended December 31, 2011** | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|---|---|
| Cash flow from operations before non-cash working capital items | **6,737** | 7,248 | **30,620** | 23,027 |
| Non-cash changes in working capital | **(30)** | 3,593 | **(3,895)** | (6,307) |
| Cash provided by (used in): | | | | |
| Operating activities | **6,707** | 10,841 | **26,725** | 16,720 |
| Investing activities | **3,087** | 1,957 | **(81,662)** | (92,254) |
| Financing activities | **(13,278)** | (11,856) | **62,240** | 90,152 |
| Increase (decrease) in cash | **(3,484)** | 942 | **7,303** | 14,618 |

### Operating activities

For the quarter ended December 31, 2011, cash flow from operations before non-cash changes in working capital totalled $6,737, compared to $7,248 in the quarter ended December 31, 2010. During the quarter ended December 31, 2011, non-cash changes in working capital used $30 of operating cash, compared to providing $3,593 in the same period in the prior year. During the current quarter, the source of cash was principally attributable to an increase in accounts payable and accrued liabilities of $1,988, the drawdown of $901 from the income support funds held in escrow and a change in income taxes of $1,081. This increase was offset by the decrease in the net government funding liability of $4,433. The increase in accounts payable and accrued liabilities is mainly due to higher trade payables and accruals due to the timing of purchases. The decrease in government funding payable is mainly timing of revenue recognition to match spending under the flow-through funding envelopes. The income tax receivable decrease was due to the receipt of the tax refund related to the prior year's filing.

For the quarter ended December 31, 2010, cash flow from operations before non-cash changes to working capital items totalled $7,248. Non-cash changes to working capital provided $3,593 of operating cash. Accounts payable and accrued liabilities increased by $3,251, an increase in the income tax provision of $627, and a decrease in accounts receivable and other assets of $765 provided sources of cash, which were partly offset by a decrease in the net government funding liability of $1,417.

For the year ended December 31, 2011, cash flow from operations before non-cash changes in working capital totalled $30,620, compared to $23,027 in the prior year. For the year ended December 31, 2011, non-cash changes to working capital used $3,895 of operating cash, compared to $6,307 in the prior year. The use of cash was attributable principally to establishing the income support of $5,500, less drawdowns in the year of $3,105, for a net use of $2,395 held in escrow which relates to the acquisition of the Royale properties. As well, an increase of $1,942 in the income taxes receivable position attributable to the timing of the payments and final tax adjustments related to the prior year, an increase in accounts receivable and other assets of $1,864, which are partly offset by an increase in government funding payable and accounts payable and accrued liabilities of $1,559 and $1,282, respectively. The increase in government funding payable is mainly due to the timing of revenue recognition to match spending under the flow-through funding envelopes. The increase in accounts payable and accrued liabilities is mainly due to higher trade payables and accruals due to the timing of purchases.

For the period from February 10, 2010 to December 31, 2010, cash flows from operations before non-cash changes to working capital items totalled $23,027. Non-cash changes in working capital used $6,307 of operating cash. Accounts payable and accrued liabilities decreased by $2,745, which was primarily due to the payment of IPO fees, a reduction in payroll related accruals due to the timing of payroll disbursements and a reduction in accrued liabilities. The net government funding payable decreased by $6,166, which was primarily due to the recognition of nine days of revenue that was deferred at March 23, 2010. Accounts receivable and other assets decreased by $535, while income taxes payable increased by $1,922.

### Investing activities

For the quarter ended December 31, 2011, investing activities provided $3,087 of cash. These funds were primarily received from construction funding of $2,133 and the reclassification of land transfer taxes as a transaction cost, previously discussed, which decreased the quarter's investment in property and equipment by $787. The increase in funds was partly offset by an investment in capitalized assets of $149, principally related to Human Resource Information System ("HRIS") project costs.

For the comparative quarter ended December 31, 2010, investing activities provided $1,957 of cash. During the quarter, Leisureworld received $2,133 in construction funding and the proceeds from the annuity of $503. These sources were partly offset by cash used for capital expenditures totalling $503 and capitalized costs related to HRIS of $204.

During the year, investing activities used cash of $81,662. These funds were used primarily for the acquisition of the two retirement properties in Kingston and Kanata, totalling $88,742. Additionally, the Company invested in property and equipment $998 mainly related to buildings. As well, the Company also invested in intangible assets totalling $575, primarily related to HRIS project costs. Partly offsetting these purchases was the amount received from construction funding of $8,532.

For the period from February 10, 2010 to December 31, 2010, cash paid for the acquisition of LSCLP amounted to $97,850, capital expenditures totalled $1,817, including HRIS project costs, and acquisition related payments were $50. Leisureworld received $6,399 in construction funding from MOHLTC and $1,006 from the annuity.

### Financing activities

During the quarter ended December 31, 2011, financing activities used cash of $13,278. During the quarter, the Company made dividend payments of $5,201, interest payments on long-term debt of $7,944, and net settlement payments of $133 on the interest rate swap contracts.

For the comparative quarter ended December 31, 2010, the Company used $11,856 of cash for financing activities. During the quarter, the Company paid interest payments of $7,523, dividend payments of $4,271, and made a net settlement payment of $62 on the interest rate swap contract.

During the year ended December 31, 2011, financing activities provided cash of $62,240. The Bridge Loan generated proceeds of $54,835, which were used to partially finance the acquisition of the two retirement properties in Kingston and Kanata. The Company's issuance of common shares also generated net proceeds of $43,857. During the year, the Company made dividend payments of $19,565, interest payments on long-term debt of $16,218, and made net settlement payments of $550 on the interest rate swap contracts.

For the period from February 10, 2010 to December 31, 2010, Leisureworld received net proceeds from the IPO of $179,038, repaid the Term Loan of $60,000 and settled a related interest rate swap contract for $1,879. The Company also paid dividends of $11,803 and interest on long-term debt of $14,923 during the period.

### Capital resources

Leisureworld's debt as at December 31, 2011 was $355,399 compared to $298,496 as at December 31, 2010. The increase of $56,903 includes $54,800 related to the Bridge Loan which was used to partially finance the acquisition of the two retirement properties. The remainder of the increase in long-term debt relates to the accretion of the fair value increment from the purchase price allocation. As at December 31, 2011, Leisureworld had a committed revolving credit facility of $10,000 with a Canadian chartered bank; the Company had no claims outstanding against this credit facility.

### Capital commitments

Leisureworld monitors all of its properties to assess its capital requirements. As part of the monitoring exercise, items are assessed and prioritized based on the urgency and necessity of the expenditure. As at December 31, 2011, total capital commitments outstanding were $506 relating to the purchase of software.

On June 22, 2010, the Company announced an agreement to acquire 88 LTC licences from Christie Gardens Apartments and Care Inc., conditional on approval by the MOHLTC. These licences are in the Toronto area and will increase the total number of the Company's LTC beds by approximately 2%. According to the terms of the agreement, the licences will be acquired by March 31, 2013 at a cost of $2,200.

Leisureworld expects to meet its operating cash requirements through 2012, including required working capital investments, capital expenditures, and currently scheduled interest payments on debt, from cash on hand, cash flow from operations and its committed borrowing capacity.

## CONTRACTUAL OBLIGATIONS AND OTHER COMMITMENTS

On November 24, 2005, LSCLP issued 4.814% Series A Senior Secured Notes due November 24, 2015 (the "2015 Notes"), which are collateralized by the assets of LSCLP and its subsidiary partnerships and guaranteed by the subsidiary partnerships.

The 2015 Notes may be redeemed in whole or in part at the option of the Company at any time, upon not less than 30 days' and not more than 60 days' notice, to the holders of the 2015 Notes. The redemption price is the greater of: (i) the face amount of the 2015 Notes to be redeemed; and (ii) the price that will provide a yield to the remaining average life of such 2015 Notes equal to the Government of Canada Yield Price plus 0.25%, plus 0.18%, in each case together with accrued and unpaid interest.

Interest on the 2015 Notes is payable semi-annually in arrears on May 24 and November 24 of each year. Interest expense on the 2015 Notes in the quarter and year ended December 31, 2011 was $4,292 and $17,026, respectively (2010 – $4,269 and $16,577, respectively), which includes non-cash interest of $531 and $2,103, respectively (2010 – $507 and $1,658, respectively). Interest on the Bridge Loan is payable monthly, the interest expense on the Bridge Loan in the quarter ended and year ended December 31, 2011 was $423 and $1,149, respectively (2010 – $nil).

Following the acquisition of LSCLP on March 23, 2010, Leisureworld used proceeds of its IPO to repay a $60,000 Term Loan and settle a related interest swap contract for $1,879.

On April 27, 2011, the Company entered into the Bridge Loan to finance the acquisition of the retirement properties in Kingston and Kanata, which bears interest at 187.5 basis points ("bps") per annum over the floating 30-day bankers' acceptance ("BA") rate. The Bridge Loan is secured by the assets of the Company's subsidiary, The Royale LP, guaranteed by the Company and is subject to certain customary financial and non-financial covenants. The Company, in conjunction with the Bridge Loan, entered into an interest rate swap contract to effectively fix the interest rate at 4.045%. The Company is not applying hedge accounting.

Leisureworld has a revolving credit facility with a Canadian chartered bank collateralized by the assets of LSCLP and its subsidiary partnerships and guaranteed by the subsidiary partnerships, which it can access for working capital purposes. The facility bears interest on cash advances at 150 bps per annum over the floating BA rate (30, 60, 90 days), or at 50 bps per annum over prime rate and on letters of credit at 150 bps per annum. As at December 31, 2011, the Company had no claims outstanding against the credit facility.

Leisureworld has a ten-year lease with respect to its corporate office, which expires on December 31, 2015. As well, there are various operating leases for office and other equipment that expire over the next five years. Payments due for each of the next five years and thereafter, for the leases and the long-term debt are as follows:

| | Operating Leases | Long-term Debt | Licences Purchase Commitment | Total |
|---|---|---|---|---|
| 2012 | 557 | — | — | **557** |
| 2013 | 520 | 55,000 | 2,200 | **57,720** |
| 2014 | 429 | — | — | **429** |
| 2015 | 371 | 310,000 | — | **310,371** |
| 2016 | — | — | — | **–** |
| Thereafter | — | — | — | **–** |
| | **1,877** | **365,000** | **2,200** | **369,077** |

## ACQUISITIONS

On April 27, 2011, Royale completed the acquisition of two retirement residences comprising 294 suites, for a net purchase price of $88,742 after working capital adjustments and an income support agreement with the vendor for $5,500 to be held in escrow as an income guarantee to complement cash flow from the properties during the lease-up period.

Royale is a limited partnership that was formed under the laws of the Province of Ontario on March 17, 2011. The sole general partner of Royale is The Royale GP Corporation ("Royale GP"), a corporation incorporated under the laws of the Province of Ontario on March 16, 2011. The Company holds all of the issued and outstanding shares of Royale GP and the limited partnership interest in Royale.

To partly finance the purchase price, the Company entered into a two-year Bridge Loan with a Canadian chartered bank in the amount of $55,000. The Bridge Loan is secured by the assets of Royale and guaranteed by the Company and is subject to certain customary financial and non-financial covenants. The Company entered into an interest rate swap contract to substantially fix the interest rate payable on the Bridge Loan at 4.045%. The balance of the purchase price was funded from the net proceeds of a public offering of subscription receipts, completed on April 27, 2011, which raised gross proceeds of approximately $46,000. On closing of the acquisition, one common share was automatically issued in exchange for each outstanding subscription receipt, resulting in the issuance of 4,381,500 common shares.

On January 12, 2012, the Company entered into an agreement to acquire the Madonna Long-Term Care Residence, a 160 bed, "A" Class home in Orleans, Ontario, a suburb of Ottawa. The purchase transaction is for $20,100, comprised of $13,400 for the operating business and approximately $6,700 of construction funding. Incremental expenses for transaction and land transfer costs are expected to be approximately $1,100. This transaction is subject to approval by the MOHLTC and the Local Health Integration Network. The transaction is expected to close in 2012.

## RELATED PARTY TRANSACTIONS

Leisureworld earned revenue from Spencer House Inc., a charitable organization that owns a licence to operate an LTC home in Orillia, Ontario. A subsidiary of the Company has been contracted to manage the operations of Spencer House Inc. Total revenue for the quarters ended December 31, 2011 and 2010 was $478 and $459, respectively. For the year ended December 31, 2011, revenue totalled $1,899 (2010 – $1,820). Included in accounts receivable was $12 owed by Spencer House Inc. at December 31, 2011 (2010 – $53). These transactions are in the normal course of operations and have been valued in the consolidated financial statements at the exchange amount, which is the amount of consideration established and agreed to by the management of the related parties. These amounts are due on demand and are non-interest bearing.

## SIGNIFICANT JUDGMENTS AND ESTIMATES

The preparation of the consolidated financial statements under IFRS requires the Company to make estimates and assumptions that affect the application of policies and reported amounts. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The estimates and assumptions which have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities are discussed below.

### Property and equipment

(i) Fair value On March 23, 2010, the Company indirectly purchased Leisureworld Senior Care LP. As part of this transaction, the property and equipment was recorded at fair value. The total fair value attributed to the property and equipment was $299,639.

On April 27, 2011, The Royale LP acquired two RRs comprising 294 suites located in Kingston and Kanata, Ontario. As part of this transaction, the property and equipment was recorded at fair value. The total fair value attributed to the property and equipment was $85,829.

(ii) Estimated useful lives Management estimates the useful lives of property and equipment based on the period during which the assets are expected to be available for use. The amounts and timing of recorded expenses for depreciation of property and equipment for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of technical or commercial obsolescence and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's property and equipment in the future.

(iii) Residual value Management estimates the residual value of property and equipment based on current market prices of similar assets. The estimates are reviewed at least annually and are updated if expectations change as a result of permanent market changes or technical or commercial obsolescence. It is possible that changes in these factors may cause significant changes in the carrying value of the Company's property and equipment in the future.

### Intangible assets

(i) Fair value On March 23, 2010, the Company indirectly purchased Leisureworld Senior Care LP. As part of this transaction, the intangible assets were recorded at fair value. The total fair value attributed to the intangible assets was $106,466.

On April 27, 2011, the Kingston and Kanata RRs were acquired by The Royale LP. As part of this transaction, the intangible assets were recorded at their fair value. The total fair value attributed to the intangible assets was $4,777.

(ii) Estimated useful lives of finite-lived intangible assets Management estimates the useful lives of finite-lived intangible assets based on the period during which the assets are expected to be available for use. The amounts and timing of recorded expenses for amortization of intangible assets for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of technical or commercial obsolescence and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's finite-lived intangible assets in the future.

(iii) Indefinite-lived intangible assets The Long-Term Care Homes Act ("LTCHA") was proclaimed into law and became effective July 1, 2010. The LTCHA contains a new licence term regime that will result in licence terms for the Leisureworld homes ranging from 15 years for Class B and C homes to a minimum of 20 years for Class A homes. Previously, Ontario LTC licences were renewed annually by MOHLTC. Under the LTCHA, ultimate control of LTC licences in Ontario remains with the MOHLTC, including approval of new licences and transfer or revocation of existing licences. With an existing wait-list of more than 20,000 in Ontario and the demand for LTC beds projected to increase, management is of the view that licences continue to have indefinite lives and will not be amortized.

### Goodwill and indefinite-lived intangible asset impairment analysis

On an annual basis, in the second quarter, the Company uses forecast cash flow information and estimates of future growth to assess whether goodwill and indefinite-lived intangible assets are impaired. If the results of operations in a future period are adverse to the estimates used for impairment testing, an impairment charge may be triggered at that point, or a reduction in useful economic life may be required. Any impairment losses are recognized in the consolidated statements of operations and comprehensive loss as an expense. Impairment losses on goodwill are not reversible.

### Share-based compensation

The assumptions used in calculating the fair value of share-based compensation have a significant impact upon the amount of the charge recognized in the consolidated statement of operations and comprehensive loss. Details of the principal assumptions used in calculating the share-based compensation expense are given in the notes to the consolidated financial statements. When a grant of share awards is made, management reviews the estimates and assumptions used to ensure appropriateness.

### Deferred taxes

Deferred tax assets and liabilities require management's judgment in determining the amounts to be recognized. In particular, judgment is used when assessing the extent to which deferred tax assets should be recognized with consideration to the timing and level of future taxable income.

### Income taxes

The actual tax on the results for the period is determined according to complex tax laws and regulations. Where the effect of these laws and regulations is unclear, estimates are used in determining the liability for tax to be paid on past profits which are recognized in the consolidated financial statements. The Company considers the estimates, assumptions and judgments to be reasonable but this can involve complex issues which may take a number of years to resolve. The final determination of prior year tax liabilities could be different from the estimates reflected in the consolidated financial statements.

## CAPITAL DISCLOSURE

The Company defines its capital as the total of its long-term debt, shareholders' equity and cash and cash equivalents.

The Company's objectives when managing capital are to: (i) maintain a capital structure that provides financing options to the Company when a financing or a refinancing need arises to ensure access to capital, on commercially reasonable terms, without exceeding its debt capacity; (ii) maintain financial flexibility in order to preserve its ability to meet financial obligations, including debt servicing payments and dividend payments; and (iii) deploy capital to provide an appropriate investment return to its shareholders.

The Company's financial strategy is designed to maintain a flexible capital structure consistent with the objectives stated above and to respond to changes in economic conditions. In order to maintain or adjust its capital structure, the Company may issue additional shares, issue additional long-term debt, issue long-term debt to replace existing long-term debt with similar or different characteristics, or adjust the amount of dividends paid to the Company's shareholders. The Company's financing and refinancing decisions are made on a specific transaction basis and depend on such things as the Company's needs and market and economic conditions at the time of the transaction.

The Board of Directors reviews the level of monthly dividends paid on a quarterly basis.

The Series A Senior Secured Notes ("the 2015 Notes") and revolving credit facility are collateralized by all assets of LSCLP and the subsidiary partnerships totalling $541,428 and guaranteed by the subsidiary partnerships. Under its Master Trust Indenture, LSCLP is subject to certain financial and non-financial covenants including a debt service coverage ratio defined as income from operations and construction funding ("EBITDA") to debt service.

The two-year credit facility ("Bridge Loan") is secured by the assets of Royale guaranteed by the Company and is subject to certain customary financial and non-financial covenants. The Company is in compliance with all financial covenants on its borrowings as of December 31, 2011. However, there can be no assurance future covenant requirements will be met. If the Company does not remain in compliance, its ability to amend the covenants or refinance its debt could be affected.

There were no changes in the Company's approach to capital management during the year.

## FINANCIAL INSTRUMENTS

Financial instruments consist of cash and cash equivalents, accounts receivable and other assets, construction funding receivable, government funding receivable/payable, annuity, accounts payable and accrued liabilities, long-term debt and interest rate swap contracts.

### Cash and cash equivalents

Cash includes deposits held with Canadian chartered banks. Cash equivalents are short-term investments with an initial maturity of less than three months. Cash and cash equivalents are classified as loans and receivables. The carrying value of cash and cash equivalents approximates fair value as it is immediately available for use.

### Accounts receivable and other assets

Accounts receivable and other assets are classified as loans and receivables. Accounts receivable and other assets are initially recorded at fair value and subsequently recognized at amortized cost. The carrying value of accounts receivable and other assets, after consideration of the provision for doubtful accounts, approximates their fair value due to the short-term maturity of these instruments.

### Construction funding receivable

The construction funding receivable is classified as loans and receivables. The construction funding receivable is initially recorded at fair value and subsequently measured at amortized cost using the effective interest method. The fair value will differ from the carrying value due to changes in interest rates.

### Annuity

The annuity was classified as loans and receivables. The annuity was initially recorded at fair value and subsequently measured at amortized cost using the effective interest method. The fair value will differ from the carrying value due to changes in interest rates.

### Accounts payable and accrued liabilities

Accounts payable and accrued liabilities are classified as other liabilities. Accounts payable and accrued liabilities are initially recorded at fair value and subsequently measured at amortized cost, which approximates fair value due to the short-term maturity of the instruments.

### Long-term debt

The Company's long-term debt is initially recorded at fair value and subsequently measured at amortized cost using the effective interest method and is classified as other liabilities. The fair value of the Company's long-term debt is subject to changes in interest rates and the Company's credit rating.

### Government funding receivable/payable

The government funding balances are classified as either other loans and receivables or liabilities which are measured at amortized cost. Government funding receivable/payable represents the difference between the amounts earned and those received from the MOHLTC, which are non-interest bearing. The carrying value of the government funding approximates its fair value. The difference between the carrying value and the fair value of the long-term portion is insignificant.

### Interest rate swap contracts

The Company has interest rate swap contracts for which hedge accounting has not been applied. The changes in fair value are recorded in the consolidated statement of operations and comprehensive loss.

### Fair value of financial instruments

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. When independent prices are not available, fair values are determined using valuation techniques that refer to observable market data. These techniques include comparisons with similar instruments where market observable prices exist, discounted cash flow analysis, and other valuation techniques commonly used by market participants. Fair values of long-term debt, interest rate swap contracts and construction funding receivable are calculated by discounted cash flow analysis based on current market rates for loans and investments with similar terms, conditions and maturities.

## NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

The following discussion is limited to the nature and extent of risks arising from financial instruments. The Company's normal operating, investing and financing activities expose it to a variety of financial risks including interest rate risk, credit risk and liquidity risk. Leisureworld is not exposed to foreign currency risk as all operations are in Canada and all purchases are contracted in Canadian dollars. The Company does not have significant exposure to price risk as most of its revenues are regulated by the MOHLTC. The Company's overall risk management process is designed to identify, manage and mitigate business risk, which includes financial risk.

### Interest rate risk

Interest rate risk arises as the fair value of future cash flows from a financial instrument can fluctuate because of changes in market interest rates. Leisureworld is exposed to interest rate risk arising from fluctuations in interest rates in connection with its interest rate swap contracts. An interest rate swap contract was purchased as part of the LSCLP acquisition and related to a hedge on anticipated borrowings for a transaction that did not occur. Leisureworld is also subject to interest rate risk on variable rate debt issued as a part of the acquisition of the Royale properties. The floating interest rate on the debt is offset by an interest rate swap contract. Leisureworld has not adopted hedge accounting for the interest rate swap contracts. Interest rates, maturities and security affecting the interest and credit risk of Leisureworld's financial assets and liabilities have been disclosed in the notes to the consolidated financial statements.

The Company's credit facilities are, and future borrowings may be, at variable rates of interest, which exposes the Company to the risk of increased interest rates.

### Credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents, accounts receivable and other assets, construction funding receivable, government funding receivable and interest rate swap contracts. The Company is exposed to credit risk from its residents and customers. However, the Company has a significant number of residents and customers, which minimizes concentration of credit risk. The credit risk related to amounts owed by the residents is further mitigated by the Company's ability to recover 50% of LTC amounts written off from the MOHLTC. A provision for management's estimate of uncollectible accounts receivable is established when there is objective evidence the Company will not be able to collect all amounts due. The Company assesses collectability of specific accounts receivable and also assesses the requirement for a provision based on historical experience. The amount of the provision is reduced by amounts that would be recovered from the MOHLTC upon ultimate write-off. When a receivable is uncollectible, it is written off against the allowance for doubtful accounts. Subsequent recoveries of amounts previously written off are credited against operating expenses in the consolidated statement of operations and comprehensive loss.

The Company is also exposed to credit risk through the amounts receivable from the MOHLTC. The Company has assessed the credit risk associated with the amounts owed by the MOHLTC as low as they are receivable from the Ontario government. Management has assessed the credit risks associated with the interest rate swap contracts and cash and cash equivalent balances as low given the counter parties are major Canadian financial institutions that have been accorded investment grade ratings by a primary rating agency.

### Liquidity risk

Liquidity risk is the risk the Company may encounter difficulties in meeting its obligations associated with financial liabilities and commitments. The Company has credit agreements in place related to the long-term debt. These credit agreements contain a number of standard financial and other covenants. A failure by the Company to comply with the obligations in these credit agreements could result in a default, which, if not rectified or waived, could permit acceleration of the relevant indebtedness.

The Company maintains a capital structure, including access to a revolving credit facility of $10,000, which helps to manage the risk of default under these credit agreements.

## CHANGE IN ACCOUNTING POLICIES

### Basis of preparation and adoption of IFRS

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as set out in the Accounting Handbook of The Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate IFRS and requires publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis. The consolidated financial statements, the term "Canadian GAAP" refers to Canadian generally accepted accounting principles before the adoption of IFRS.

The consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of financial statements, including IFRS 1, First-Time Adoption of International Financial Reporting Standards. As at February 10, 2010, the date of incorporation and transition to IFRS, the Company's consolidated statement of financial position only included share capital and cash of $10.00. As a result, a transitional consolidated statement of financial position has not been presented as it provides no meaningful information to the users of the consolidated financial statements. The Company has consistently applied the same accounting policies throughout all periods presented, as if these policies had always been in effect.

The effect of the Company's transition to IFRS, described above, is summarized as follows:

(a) Reconciliation of shareholders' equity as previously reported under Canadian GAAP to IFRS

(b) Reconciliation of net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS

It should be noted that since the Company was formed on February 10, 2010, the transition elections in accordance with IFRS 1 are not applicable.

(a) Reconciliation of shareholders' equity as previously reported under Canadian GAAP to IFRS

| | Notes | December 31, 2010 |
|---|---|---|
| **Shareholders' equity as reported under Canadian GAAP** | | 171,158 |
| IFRS adjustments increase (decrease): | | |
| Property and equipment | (i) | (4,226) |
| Acquisition related costs | (ii) | (35) |
| Deferred income taxes | (iii) | 1,294 |
| | | (2,967) |
| **Shareholders' equity as reported under IFRS** | | **168,191** |

(i) Property and equipment Under IFRS, the significant individual components of property and equipment with different useful lives are required to be separately identified and measured whereas management had not determined components under Canadian GAAP at the time of acquisition of the assets. The changes in property and equipment relate to differences in depreciation of the property and equipment which were impacted by componentization.

(ii) Acquisition related costs In accordance with Canadian GAAP, costs directly attributable to an acquisition are capitalized. Under IFRS, these costs are required to be expensed.

(iii) Deferred income taxes The change in shareholders' equity related to deferred income taxes reflect the change in temporary differences resulting from the effect of the IFRS adjustments described in (a)(i) and (a)(ii) above.

(b) Reconciliation of net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS

| | Notes | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|
| **Net loss and comprehensive loss as reported under Canadian GAAP** | | (4,132) |
| IFRS adjustments increase (decrease): | | |
| Property and equipment | (i) | (4,226) |
| Acquisition related costs | (ii) | (35) |
| Deferred income taxes | (iii) | 1,294 |
| | | (2,967) |
| **Net loss and comprehensive loss as reported under IFRS** | | **(7,099)** |

(i) Property and equipment As described in (a)(i), the changes in property and equipment relate to differences in depreciation of the property and equipment, which were impacted by componentization under IFRS.

(ii) Acquisition related costs As described in (a)(ii), costs related to acquisitions are required to be expensed as incurred under IFRS.

(iii) Deferred income taxes Deferred income taxes are impacted by the change in temporary differences resulting from the effect of the IFRS reconciling items described in (b)(i) and (b)(ii) above.

## ACCOUNTING STANDARDS ISSUED BUT NOT YET APPLIED

### IFRS 9, Financial Instruments

IFRS 9, Financial instruments, addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39, Financial Instruments – Recognition and Measurement, that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the consolidated statement of operations, unless this creates an accounting mismatch. IFRS 9 is required to be applied for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company has decided not to early adopt this standard.

### IFRS 10, Consolidated Financial Statements

IFRS 10, Consolidated Financial Statements, changes the definition of control under IFRS so that the same criteria are applied to all entities to determine control. IFRS 10 supersedes the guidance on control and consolidation in IAS 27, Consolidated and Separate Financial Statements, and SIC-12, Consolidation – Special Purpose Entities. The future accounting policy changes are effective for annual periods beginning on or after January 1, 2015 with early adoption permitted. The Company has decided not to early adopt this standard.

### IFRS 13, Fair Value Measurement

IFRS 13, Fair Value Measurement, provides a single source of guidance on how to measure fair value where its use is already required or permitted by other IFRS and enhances disclosure requirements for information about fair value measurements. The future accounting policy changes are effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has decided not to early adopt this standard.

There are no other accounting standards issued but not yet applied that would be expected to have a material impact on the Company.

## RISKS AND UNCERTAINTIES

### LTC home ownership and operation

By investing indirectly in the Leisureworld business, investors may be exposed to the general business risks inherent in the seniors' housing industry. These risks include fluctuations in levels of occupancy and the inability to achieve accommodation funding or residency fees (including anticipated increases in such fees). The inability to achieve such funding or fees could occur as a result of, among other factors, regulations controlling LTC funding; regulations controlling rents for RH and IL homes; possible future changes in labour relations; increases in labour costs, other personnel costs, and other operating costs; competition from or oversupply of other similar properties; changes in conditions of the Leisureworld LTC homes or general economic conditions; and the imposition of increased or new taxes. These risks also include the effects of health-related risks and disease outbreaks. As such, there is no assurance future occupancy rates at the Leisureworld LTC homes will be consistent with historical occupancy rates achieved and this could have an adverse impact on the business, operating results and financial condition of LSCLP, which could adversely affect the Company's results and the Company's ability to pay dividends on the common shares.

### The provincial regulation of LTC homes includes control of fees

The provincial regulation of LTC homes includes the control of LTC fees. The MOHLTC funds care and support programs provided in LTC homes and subsidizes accommodation costs for qualifying residents. As a result of increasing healthcare costs, the risk exists that funding agencies may in the future reduce the level of, or eliminate, such fees, payments or subsidies. There can be no assurance that the current level of such fees, payments and subsidies will be continued or that such fees, payments and subsidies will increase commensurate with expenses. A reduction of these fees, payments or subsidies could have an impact on the business, operating results or financial condition of Leisureworld, which could adversely affect the Company's results and ability to pay dividends to shareholders, and could result in an increase to the AFFO payout ratio if the same level of dividends is maintained.

### In the Province of Ontario, all LTC homes are funded and must be licensed

Ontario's Long-Term Care Homes Act, 2007 ("LTCHA"), was proclaimed into law and became effective July 1, 2010. The LTCHA contains a new licence term regime for all LTC homes which will result in licence terms for the Leisureworld homes ranging from 15 years for Class B and C homes to a minimum of 20 years for Class A homes. Under the LTCHA, ultimate control of LTC licences in Ontario remains with the MOHLTC including approval of new licences, and transfer or revocation of existing licences. With an existing wait-list of approximately 20,000 in Ontario and the demand for LTC beds projected to increase, management is of the view that licences will continue to be renewed and have indefinite lives. A failure of Leisureworld's LTC licences to be renewed or conditional renewal could have an impact on the Leisureworld business.

The LTCHA also contains a number of other potentially problematic provisions including proscriptions on the terms of external management agreements, onerous reporting requirements and restrictions relating to a broad range of non-arm's length transactions, circumscription on lenders' rights on enforcement and more stringent controls on LTC purchase and sale transactions.

The introduction of local health integration networks ("LHINs") is also expected to generate changes in the administration of LTC homes. As LHINs are to be the primary body setting local performance goals, it is possible the current system of standards described herein could be significantly changed in the near future. Further, it is possible the interpretation of standards for LTC homes could differ between LHINs.

It is unclear what impact the LTCHA or the implementation of LHINs will have on Leisureworld and the LTC industry as a whole.

The Sharkey Report issued by the MOHLTC in June 2008 contains recommendations with respect to minimum staffing at LTC homes. Although there has been no recent activity in response to the report, it is possible the Government of Ontario will implement minimum staffing requirements in the future, which would be expected to be funded.

All LTC homes are subject to surveys and inspections by government authorities to ensure compliance with applicable laws and to investigate complaints, including resident injury or death. It is not unusual for the stringent MOHLTC inspection procedures to identify deficiencies in operations across LTC homes in Ontario. Every effort is made by the Company to correct legitimate problem areas that have been identified; however, certain Leisureworld homes have had to file plans of correction and ensure sustained compliance with such plans. It is possible the Company may not be able to remedy deficiencies or address complaints within the time frames allowed or in a manner satisfactory to the MOHLTC, which could lead to the MOHLTC requiring periods of enhanced monitoring and imposing sanctions (such as limiting admissions at the applicable LTC home), which, in turn, could have an impact on the Leisureworld business.

### Home healthcare risks

The government's Bill 139 proposes, among other things, to remove the elect-to-work exemptions to severance, and notice of termination. As it is currently drafted, Bill 139 does not appear to apply to elect-to-work employees of agencies, such as PHCS, providing services pursuant to contracts with the CCACs. However, management understands the government intends to revoke this exemption in 2012. Owing to the level and extent of criticism and concern, Bill 139 was referred to a standing committee. Additionally, as described under ''Ontario Home Healthcare and Regulation and Funding", the Caplan Report recommended a number of changes to the Ontario home healthcare system. It is difficult to predict what further recommendations may be implemented under the Caplan Report or to determine the impact of changes to elect-to-work employee regulation. While these issues pose no significant immediate concern to Leisureworld, they may impact Leisureworld's plans to expand its home healthcare business.

### Acquisitions

The success of senior housing and care business acquisition activities of Leisureworld will be determined by numerous factors, including the ability of the Company to identify suitable acquisition targets, competition for acquisition opportunities, purchase price, ability to obtain adequate financing on reasonable terms, financial performance of the businesses after acquisition, and the ability of the Company to effectively integrate and operate the acquired businesses. Acquired businesses may not meet financial or operational expectations due to unexpected costs associated with the acquisition, as well as the general investment risks inherent in any real estate investment or business acquisition. Moreover, new acquisitions may require significant management attention or capital expenditures that would otherwise be allocated to existing businesses. Any failure by the Company to identify suitable candidates for acquisition or operate the acquired businesses effectively may have an adverse effect on the business, results of operations or financial condition of the Company.

### Capital intensive industry

The ability of Leisureworld to maintain and enhance its LTC homes in a suitable condition to meet regulatory standards, operate efficiently and remain competitive in its markets will require the Company to commit a substantial portion of cash to physical centres and equipment. Certain competitors of the Company may operate homes that are not as old as those owned by the Company, or that may appear more modern, and therefore, may be attractive to potential patients and residents. Significant future capital requirements could have a material adverse effect on the business, operating results or financial condition of the Company, which could adversely affect the Company's results and ability to pay dividends to its shareholders.

### The Company's ability to obtain additional financing may be limited, which could delay or prevent the completion of one or more of its strategies

The Company expects its working capital needs and capital expenditure needs to increase in the future as it continues to expand and enhance its LTC facilities and as it continues to implement other strategies. The Company's ability to raise additional capital will depend on the financial success of its current business and the successful implementation of its key strategic initiatives, financial, economic and market conditions and other factors, some of which are beyond its control. No assurance can be given that it will be successful in raising the required capital at reasonable cost and at the required times, or at all. Further equity financings may have a further dilutive effect on shareholders. If Leisureworld requires additional debt financing, the lenders may require it to agree on restrictive covenants that could limit its flexibility in conducting future business activities, and the debt service payments may be a significant drain on free capital allocated for research and other activities. If the Company is unsuccessful in raising additional capital, it may not be able to continue its business operations and advance its growth initiatives, which could adversely impact the Company's results and the ability to pay dividends to its shareholders.

### Redevelopment of Class B and C homes

The Company intends to redevelop, over the next 5 to 15 years, all of its Class B and Class C homes pursuant to the MOHLTC Capital Renewal Initiatives. The redevelopment plans include significant capital outlays which are expected to be funded with a combination of cash on hand, working capital lines, construction facilities and conventional and/or CMHC insured financing. To the extent such redevelopment plans are not implemented or proceed on significantly different timing or terms, including with respect to the levels of expected MOHLTC funding, there could be an adverse effect on the Company's results and ability to pay dividends to its shareholders.

### Real property ownership

All real property investments are subject to a degree of risk. They are affected by various factors, including changes in general economic conditions (such as the availability of long-term mortgage funds) and in local conditions (such as an oversupply of space or a reduction in demand for real estate in the area), the attractiveness of the properties to residents, competition from other available space and various other factors, including increasing property taxes. In addition, fluctuations in interest rates could have a material adverse effect on the business, operating results or financial condition of Leisureworld.

### Rising healthcare and electricity costs

Healthcare costs have been rising and are expected to continue to rise at a rate higher than that anticipated for consumer goods and services as a whole. The business, operating results or financial condition of the Company could be adversely affected if it is unable to implement annual private-pay increases due to market conditions or if funding rates from the MOHLTC are not appropriately adjusted to cover increases in labour and other costs.

Electricity costs have been rising at rates in excess of inflation throughout Ontario and are expected to further increase. If these cost increases continue and are not offset by funding increases or increases in preferred accommodation rates there could be a negative impact on the cash flow of the Company.

### Reconciliations of MOHLTC funding will result in current year adjustments made in respect of prior years

Reconciliations of MOHLTC funding versus actual expenses are performed annually, based on previous calendar years. From time to time, the reconciliations will result in current year adjustments made in respect of prior years. These ''prior period adjustments'' can have either a favourable or unfavourable impact on NOI generally related to differences identified in the reconciliation attributable to occupancy days, special circumstances and differences between projected and actual property tax.

### The MOHLTC is transitioning its approach to funding the NPC envelope

The MOHLTC is changing the classifications used in calculating funding for the NPC envelope. Similar to the old system, the new methodology uses resident clinical and functional information for calculating a care resource allocation. However, there are a number of differences between the elements and relative weight factors and these differences may produce different outcomes. In addition, new technical knowledge and proficiency in applying the methodology will be required. In this learning phase, it is not clear what impact the new methodology and its application will have on the calculation of funding outcomes. Although no significant overall changes are anticipated, Leisureworld has taken measures (such as increasing its capacity to work with the new methodology) to recapture funding reductions.

### There can be no assurance the Company will continue to generate sufficient cash flow from operations

A portion of the Company's cash flow is devoted to servicing its debt and there can be no assurance LSCLP will continue to generate sufficient cash flow from operations to meet the required interest and principal payments on the 2015 Notes or drawings under its revolving credit facility. If the Company were unable to meet such interest or principal payments, it could be required to seek renegotiation of such payments or obtain additional equity, debt or other financing. If this were to occur, it could have an impact upon the business, operating results or financial condition of Leisureworld, which could adversely affect the Company's results and the Company's ability to pay dividends on its common shares.

### All of the employees working at the Leisureworld homes are unionized, with the exception of management and third party providers with OLTC and employees of PHCS

Employees working at the Leisureworld homes are unionized with approximately 80% of employees represented by union locals of either the Service Employees International Union, the Ontario Nurses Association, the Christian Labour Association of Canada, the Canadian Union of Public Employees or the Canadian Auto Workers. While the Company has traditionally maintained positive labour relations, there can be no assurance the Leisureworld homes will not at any time, whether in connection with a renegotiation process or otherwise, experience strikes, labour stoppages or any other type of conflict with unions or employees, which could have a material adverse effect on the Company's operating results and financial condition. However, all LTC homes in the Province of Ontario are governed by the Hospital Labour Disputes Arbitration Act (Ontario), which prohibits strikes and lockouts in the seniors housing industry. Therefore, collective bargaining disputes are more likely to be resolved through compulsory third party arbitration.

### The Leisureworld business is labour intensive

The Leisureworld business is labour intensive, with labour-related costs comprising a substantial portion of the Company's direct operating expenses. The Leisureworld business competes with other healthcare providers with respect to attracting and retaining qualified personnel. The LTC industry is currently facing a shortage of qualified personnel, such as nurses, pharmacists, certified nurse's assistants, nurse's aides, therapists, and other important providers of healthcare services. The shortage of qualified personnel and general inflationary pressures may require the Company to enhance its pay and benefits package to compete effectively for such personnel, the costs of which are included in the annual operating budget for each home. The Company may not be able to offset such added costs by increasing the rates charged to patients and residents. An increase in these costs or a failure to attract, train and retain qualified and skilled personnel could adversely affect the business, results of operations and financial condition of the Company. No assurance can be given that labour costs will not increase, or that if they do increase, that they will be matched by corresponding increases in revenue. Wage increases in excess of increases that can be obtained from increases in rental or cost reimbursement could have an impact upon the business, operating results, and financial condition of the Company, which could adversely affect the Company's results and the Company's ability to pay dividends on its common shares.

### The Company is heavily dependent on certain of its key executives and other personnel

The Company's success depends heavily on its ability to attract, retain and motivate key employees, including senior management. If the Company loses the services of any of its key executives and cannot replace them in a timely manner, its business and prospects may be adversely affected. Since the Company is managed by a small group of executive officers, the loss of the technical knowledge, management expertise and knowledge of operations of one or more members of the Company's executive management team could result in a diversion of management resources, as the remaining members of management would need to cover the duties of any executive officer who leaves the Company and would need to spend time usually reserved for managing the business to search for, hire and train new members of management. The loss of some or all of the Company's executives could negatively affect the Company's ability to develop and pursue its business strategy which could adversely affect the Company's business and financial results. The Company does not currently carry any ''key man'' life insurance on its executives.

### Any significant damage to administrative or Leisureworld properties, as a result of fire or other calamities, could have a material adverse effect

Leisureworld's ability to sustain or grow its business is heavily dependent on efficient, proper and uninterrupted operations at its Leisureworld homes. Power failures or disruptions, the breakdown, failure or substandard performance of equipment, the improper installation or operation of equipment and the destruction of buildings, equipment and other facilities due to natural disasters such as hurricanes, fire or earthquakes would severely affect its ability to continue operations. While it does maintain certain insurance policies covering losses due to fire, lightning and explosions, there can be no assurance its coverage would be adequate to compensate Leisureworld for the actual cost of replacing such buildings, equipment and infrastructure nor can there be any assurance that such events would not have a material adverse effect on its business, financial condition, results of operations or prospects.

### Liability and insurance

The businesses, which are carried on, directly or indirectly, by Leisureworld, entail an inherent risk of liability, including with respect to injury to or death of its residents. Management expects that from time to time Leisureworld may be subject to such lawsuits as a result of the nature of its businesses. Leisureworld maintains business and property insurance policies in amounts and with such coverage and deductibles as deemed appropriate, based on the nature and risks of the businesses, historical experience and industry standards. There can be no assurance, however, that claims in excess of the insurance coverage or claims not covered by the insurance coverage will not arise or that the liability coverage will continue to be available on acceptable terms.

A successful claim against Leisureworld not covered by, or in excess of, Leisureworld's insurance could have a material adverse effect on Leisureworld's businesses, operating results and financial condition. Claims against Leisureworld, regardless of their merit or eventual outcome, also may have a material adverse effect on its ability to attract residents or expand its businesses (particularly where such claims receive negative media exposure), and will require management to devote time to matters unrelated to the operation of the business.

#### Competition

Numerous other seniors housing facilities compete with Leisureworld in seeking residents. While the existence of competing owners and competition for Leisureworld residents could have an adverse effect on the Company's ability to find residents for its seniors housing facilities and on the rents charged, and could adversely affect the Company's revenues and its ability to meet its debt obligations, any impact from competition is expected by management to be mitigated by the growing wait list numbers for LTC and the barriers to entry into the LTC industry.

#### Geographic concentration

All of the business and operations of Leisureworld are conducted in Ontario. The fair value of the Leisureworld assets and the income generated therefrom could be negatively affected by changes in local and regional economic conditions. However, management believes the LTC sector in Ontario is currently a desirable market in which to operate, particularly when contrasted to comparable US markets in terms of general economic conditions and government funding rates for skilled nursing.

#### Changes in the Company's credit ratings may affect the market price of the common shares

The credit ratings assigned to the 2015 Notes are an assessment of the Company's ability to pay its obligations. Consequently, real or anticipated changes in the Company's credit ratings will generally affect the fair value of the common shares.

### RISKS RELATING TO A PUBLIC COMPANY AND COMMON SHARES

#### Volatile market price for common shares

The market price for common shares may be volatile and subject to wide fluctuations in response to numerous factors, many of which are beyond the Company's control, including the following:

- actual or anticipated fluctuations in the Company's quarterly results of operations;
- changes in estimates of future results of operations by Leisureworld or securities research analysts;
- changes in the economic performance or market valuations of other companies that investors deem comparable to the Company;
- addition or departure of the Company's executive officers and other key personnel;
- release or other transfer restrictions on outstanding common shares;
- sales or perceived sales of additional common shares;
- significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving the Company or its competitors; and
- news reports relating to trends, concerns or competitive developments, regulatory changes and other related issues in the Company's industry or target markets.

Financial markets have recently experienced significant price and volume fluctuations that have particularly affected the market prices of equity securities of companies and that have, in many cases, been unrelated to the operating performance, underlying asset values or prospects of such companies. Accordingly, the market price of the common shares may decline even if the Company's operating results, underlying asset values or prospects have not changed. Additionally, these factors, as well as other related factors, may cause decreases in asset values that are deemed to be other than temporary, which may result in impairment losses. As well, certain institutional investors may base their investment decisions on consideration of the Company's environmental, governance and social practices and performance against such institutions' respective investment guidelines and criteria, and failure to meet such criteria may result in a limited or no investment in the common shares by those institutions, which could adversely affect the trading price of the common shares. There can be no assurance that continuing fluctuations in price and volume will not occur. If such increased levels of volatility and market turmoil continue, the Company's operations and the trading price of the common shares may be adversely affected.

### The Company is a holding company

The Company is a holding company and a substantial portion of its assets are the partnership units of its subsidiaries. As a result, investors in the Company are subject to the risks attributable to its subsidiaries. As a holding company, the Company conducts substantially all of its business through its subsidiaries, which generate substantially all of its revenues. Consequently, the Company's cash flows and ability to complete current or desirable future enhancement opportunities are dependent on the earnings of its subsidiaries and the distribution of those earnings to the Company. The ability of these entities to pay dividends and other distributions will depend on their operating results and will be subject to applicable laws and regulations which require that solvency and capital standards be maintained by such companies and contractual restrictions contained in the instruments governing their debt. In the event of a bankruptcy, liquidation or reorganization of any of the Company's subsidiaries, holders of indebtedness and trade creditors will generally be entitled to payment of their claims from the assets of those subsidiaries before any assets are made available for distribution to the Company.

### Dividend policy

The Board established a dividend policy pursuant to completion of the Offering, to initially authorize the declaration and payment of an annual dividend of $0.85 per common share, to be paid to holders of common shares on a monthly basis. Any determination to pay cash dividends will be at the discretion of the Board after taking into account such factors as the Company's financial condition, results of operations, current and anticipated cash needs, regulatory capital requirements, the requirements of any future financing agreements and other factors that the Board may deem relevant, with a view to paying dividends whenever operational circumstances permit.

### The Company needs to comply with financial reporting and other requirements as a public company

As a result of the IPO, the Company is subject to reporting and other obligations under applicable Canadian securities laws and Toronto Stock Exchange rules, including NI 52-109. These reporting and other obligations place significant demands on the Company's management, administrative, operational and accounting resources. Moreover, any failure to maintain effective internal controls could cause the Company to fail to meet its reporting obligations or result in material misstatements in its consolidated financial statements. If the Company cannot provide reliable financial reports or prevent fraud, its reputation and operating results could be materially harmed, which could also cause investors to lose confidence in the Company's reported financial information, which could result in a lower trading price of its common shares.

Management does not expect that Company's disclosure controls and procedures and internal controls over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that its objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Due to the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by individual acts of some persons, by collusion of two or more people or by management override of the controls. Due to the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

### Future sales of common shares by directors and executive officers

Subject to compliance with applicable securities laws, officers and directors and their affiliates may sell some or all of their common shares in the future. No prediction can be made as to the effect, if any, such future sales of common shares will have on the market price of the common shares prevailing from time to time. However, the future sale of a substantial number of common shares by the

Company's officers and directors and their affiliates, or the perception that such sales could occur, could adversely affect prevailing market prices for the common shares.

### Directors and officers may have conflicts of interest

Certain of the directors and officers of the Company also serve as directors and/or officers of other companies and consequently there exists the possibility for such directors and officers to be in a position of conflict. Any decision made by any of such directors and officers involving the Company are being made in accordance with their duties and obligations to deal fairly and in good faith with a view to the best interests of the Company.

### Dilution and future sales of common shares may occur

The Company's articles permit the issuance of an unlimited number of common shares and an unlimited number of preferred shares, and shareholders will have no pre-emptive rights in connection with such further issuances. The directors of the Company have the discretion to determine the price and the terms of issue of further issuances of common shares and preferred shares.

## DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining a system of disclosure controls and procedures to provide reasonable assurance that all material information relating to the Company and its subsidiaries is gathered and reported to senior management on a timely basis so that appropriate decisions can be made regarding public disclosure.

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

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

The CEO and CFO evaluated the design and operating effectiveness of the Company's internal controls over financial reporting for the year ended December 31, 2011. Based on this evaluation, the CEO and CFO concluded that the Company's internal controls over financial reporting were effective as at December 31, 2011. There have been no changes in the Company's internal controls over financial reporting during the year ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## OUTLOOK

Leisureworld will continue to focus on enhancing the quality of care and accommodation for residents. The Company expects to continue to benefit from excellent industry fundamentals, including favourable demographics and increasing life expectancies, and maintain occupancy rates at or above 97% on average across its LTC portfolio. Leisureworld's core LTC portfolio, disciplined cost control, and improving NOI performance from the Royale retirement properties, form a strong platform for reliable shareholder dividends and strategic long-term growth. Leisureworld expects to pay a monthly dividend to its shareholders of $0.0708 per common share, representing $0.85 per share on an annualized basis.

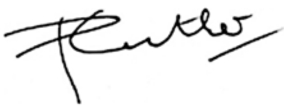
As the Province of Ontario and other provinces in Canada look for ways to contain healthcare spending, management believes that private delivery of certain healthcare services by trusted providers, such as Leisureworld, represents a cost-effective solution. With its strong balance sheet, Leisureworld is well positioned to capitalize on growth opportunities across the entire spectrum of government regulated, seniors living and care services sector in Canada.

Looking ahead, Leisureworld will focus on its strategy of: delivering high quality care service and accommodation for seniors; supporting and increasing occupancy rates; identifying opportunities to augment its LTC portfolio, through the renewal of its older LTC facilities, or complementary acquisitions; and increasing its presence across the continuum of seniors living and care in Canada.

The consolidated financial statements are the responsibility of the management of Leisureworld Senior Care Corporation (the "Company"), and have been approved by the Board of Directors of the Company. These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and include amounts that are based on estimates and judgments. Financial information contained elsewhere in this Report is consistent with the consolidated financial statements.

The Company maintains a system of internal controls that are designed to provide reasonable assurance that the financial records are reliable and accurate and form a proper basis for the preparation of the financial statements.

The external auditors, PricewaterhouseCoopers LLP, have audited the consolidated financial statements in accordance with IFRS. The following report of PricewaterhouseCoopers LLP outlines the scope of their examination and their opinion on the consolidated financial statements.



**David Cutler**
Chief Executive Officer
Markham, Canada
February 22, 2012

**Manny DiFilippo**
Chief Financial Officer

**To the Shareholders of Leisureworld Senior Care Corporation**

We have audited the accompanying consolidated financial statements of Leisureworld Senior Care Corporation and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2011 and December 31, 2010 and the consolidated statements of changes in shareholders' equity, operations and comprehensive loss and cash flows for the year ended December 31, 2011 and period from incorporation, February 10, 2010, to December 31, 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

**Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Leisureworld Senior Care Corporation and its subsidiaries as at December 31, 2011 and December 31, 2010 and their financial performance and their cash flows for the year ended December 31, 2011 and period from incorporation, February 10, 2010, to December 31, 2010 in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

**Chartered Accountants, Licensed Public Accountants**
Toronto, Ontario
February 22, 2012

# Consolidated Statements of Financial Position

Thousands of dollars

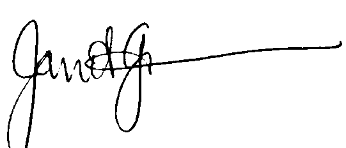
| | Notes | December 31, 2011 | December 31, 2010 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | 8 | **21,921** | 14,618 |
| Accounts receivable and other assets | 23 | **5,564** | 3,687 |
| Income support | 7 | **2,395** | – |
| Prepaid expenses and deposits | | **1,639** | 999 |
| Government funding receivable | | **2,440** | 2,345 |
| Construction funding receivable | 21 | **5,621** | 5,406 |
| Income taxes receivable | | **20** | – |
| | | **39,600** | 27,055 |
| Government funding receivable | | **163** | 455 |
| Construction funding receivable | 21 | **69,533** | 75,169 |
| Property and equipment | 9 | **357,416** | 287,967 |
| Intangible assets | 10 | **86,373** | 96,309 |
| Goodwill | 11 | **91,466** | 91,466 |
| **Total assets** | | **644,551** | 578,421 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | 16 | **35,331** | 32,967 |
| Government funding payable | | **4,082** | 3,389 |
| Interest rate swap contracts | | **688** | – |
| Income taxes payable | | **–** | 1,922 |
| | | **40,101** | 38,278 |
| Long-term debt | 12 | **355,399** | 298,496 |
| Deferred income taxes | 14 | **64,128** | 70,226 |
| Government funding payable | | **3,691** | 3,022 |
| Interest rate swap contracts | | **204** | 208 |
| **Total liabilities** | | **463,523** | 410,230 |
| **SHAREHOLDERS' EQUITY** | | | |
| Share capital | 15 | **233,207** | 188,517 |
| Deficit | 4 | **(52,179)** | (20,326) |
| Total shareholders' equity | | **181,028** | 168,191 |
| **Total liabilities and shareholders' equity** | | **644,551** | 578,421 |

Commitments and contingencies 20, 27

See accompanying notes.

Approved by the Board of Directors of Leisureworld Senior Care Corporation.

**Dino Chiesa**
Chairman and Director



**Janet Graham**
Director

# Consolidated Statements of Changes in Shareholders' Equity

Thousands of dollars

| | Notes | Share Capital | Deficit | Total Shareholders' Equity |
|---|---|---|---|---|
| **Balance, December 31, 2010** | | **188,517** | **(20,326)** | **168,191** |
| **Issuance of shares** | **15** | **44,394** | **–** | **44,394** |
| **Net loss and comprehensive loss** | | **–** | **(11,977)** | **(11,977)** |
| **Share-based compensation** | **17** | **296** | **–** | **296** |
| **Dividends** | **16** | **–** | **(19,876)** | **(19,876)** |
| **Balance, December 31, 2011** | | **233,207** | **(52,179)** | **181,028** |

| | Notes | Share Capital | Deficit | Total Shareholders' Equity |
|---|---|---|---|---|
| Balance, February 10, 2010 | | – | – | – |
| Issuance of shares | 15 | 187,803 | – | 187,803 |
| Net loss and comprehensive loss | | – | (7,099) | (7,099) |
| Share-based compensation | 17 | 714 | – | 714 |
| Dividends | 16 | – | (13,227) | (13,227) |
| Balance, December 31, 2010 | | 188,517 | (20,326) | 168,191 |

See accompanying notes.

# Consolidated Statements of Operations and Comprehensive Loss

Thousands of dollars, except share and per share data

| | Notes | Year Ended December 31, 2011 | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|---|
| **Revenue** | 23, 24 | **290,107** | 213,608 |
| **Expenses** | | | |
| Operating | 25 | **276,834** | 203,860 |
| Administrative | 17, 25 | **15,114** | 8,961 |
| | | **291,948** | 212,821 |
| **Income (loss) from operations** | | **(1,841)** | 787 |
| Finance costs | 12 | **18,938** | 13,477 |
| Finance income | 12 | **(3,232)** | (2,847) |
| **Net finance charges** | | **15,706** | 10,630 |
| **Loss before income taxes** | | **(17,547)** | (9,843) |
| **Provision for (recovery of) income taxes** | | | |
| Current | 14 | **1,185** | 1,922 |
| Deferred | 14 | **(6,755)** | (4,666) |
| | | **(5,570)** | (2,744) |
| **Net loss and comprehensive loss attributable to shareholders** | | **(11,977)** | (7,099) |
| Basic and diluted loss per share | | **($0.52)** | ($0.41) |
| Weighted average number of common shares outstanding | | **23,024,705** | 17,394,149 |

See accompanying notes.

# Consolidated Statements of Cash Flows

Thousands of dollars

| | Notes | Year Ended December 31, 2011 | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|---|
| **OPERATING ACTIVITIES** | | | |
| **Net loss** | | **(11,977)** | (7,099) |
| Add (deduct) items not affecting cash | | | |
| Depreciation of property and equipment | | **17,378** | 12,617 |
| Amortization of intangible assets | | **15,288** | 11,029 |
| Deferred income taxes | | **(6,755)** | (4,666) |
| Share-based compensation | | **296** | 714 |
| Loss (gain) on interest rate swap contracts | | **684** | (198) |
| Net finance charges | | **15,706** | 10,630 |
| | | **30,620** | 23,027 |
| **Non-cash changes in working capital** | | | |
| Accounts receivable and other assets | | **(1,864)** | 535 |
| Prepaid expenses and deposits | | **(535)** | 147 |
| Income taxes payable/receivable | | **(1,942)** | 1,922 |
| Accounts payable and accrued liabilities | | **1,282** | (2,745) |
| Income support | | **(2,395)** | – |
| Government funding, net | | **1,559** | (6,166) |
| **Cash provided by operating activities** | | **26,725** | 16,720 |
| **INVESTING ACTIVITIES** | | | |
| Purchase of property and equipment | | **(998)** | (945) |
| Purchase of intangible assets | | **(575)** | (872) |
| Amounts received from construction funding | | **8,532** | 6,399 |
| Interest received from cash and cash equivalents | | **121** | 58 |
| Acquisition of Leisureworld Senior Care LP, net of cash acquired | 7 | **–** | (97,850) |
| Acquisition of the Royale properties, net of cash acquired | 7 | **(88,742)** | – |
| Proceeds from annuity | | **–** | 1,006 |
| Acquisition related payments | | **–** | (50) |
| **Cash used in investing activities** | | **(81,662)** | (92,254) |
| **FINANCING ACTIVITIES** | | | |
| Repayment of long-term debt | | – | (60,000) |
| Proceeds from issuance of long-term debt | | **54,835** | – |
| Deferred financing costs | | **(119)** | – |
| Repayment of interest rate swap contract | | – | (1,879) |
| Net settlement payment on interest rate swap contracts | | **(550)** | (281) |
| Interest paid on long-term debt | | **(16,218)** | (14,923) |
| Dividends paid | | **(19,565)** | (11,803) |
| Net proceeds from issuance of common shares | | **43,857** | 179,038 |
| **Cash provided by financing activities** | | **62,240** | 90,152 |
| **Increase in cash and cash equivalents during the period** | | **7,303** | 14,618 |
| Cash and cash equivalents, beginning of period | | **14,618** | – |
| **Cash and cash equivalents, end of period** | | **21,921** | 14,618 |
| **Supplementary information** | | | |
| Income taxes paid | | **4,078** | – |

See accompanying notes.

## 1. ORGANIZATION

Leisureworld Senior Care Corporation ("Leisureworld" or the "Company") was incorporated under the laws of the Province of Ontario on February 10, 2010 and was continued under the laws of the Province of British Columbia on March 18, 2010. The Company closed its Initial Public Offering ("IPO") on March 23, 2010 and acquired, indirectly, all of the outstanding limited partnership interests in Leisureworld Senior Care LP ("LSCLP") and common shares of Leisureworld Senior Care GP Inc., the general partner of LSCLP. On April 27, 2011, two additional retirement residences comprising 294 suites located in Kingston and Kanata, Ontario were acquired by the Company's subsidiary, The Royale LP ("Royale").

Leisureworld and its predecessors have been operating since 1972. The Company's head office is located at 302 Town Centre Blvd., Markham, Ontario, L3R 0E8. Leisureworld owns and operates 26 long-term care ("LTC") homes (representing an aggregate of 4,314 beds), all of which are located in the Province of Ontario. Leisureworld also owns and operates three retirement residences ("RR") (representing 323 suites) and one Independent Living residence ("IL") (representing 53 apartments) in the Province of Ontario. Ancillary businesses of the Company include Preferred Health Care Services ("PHCS"), an accredited provider of professional nursing and personal support services for both community-based home healthcare and LTC homes.

The Company is a public company listed on the TSX.

## 2. BASIS OF PREPARATION AND ADOPTION OF IFRS

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as set out in the Accounting Handbook of The Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate IFRS and requires publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis. In these consolidated financial statements, the term "Canadian GAAP" refers to Canadian generally accepted accounting principles before the adoption of IFRS.

These consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of financial statements, including IFRS 1, First-Time Adoption of International Financial Reporting Standards. As at February 10, 2010, the date of incorporation and transition to IFRS, the Company's consolidated statement of financial position only included share capital and cash of $10.00. As a result, a transitional consolidated statement of financial position has not been presented as it provides no meaningful information to the users of the consolidated financial statements. The Company has consistently applied the same accounting policies throughout all periods presented, as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the Company's reported consolidated statements of financial position, changes in shareholders' equity, operations and comprehensive loss and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the period ended December 31, 2010 prepared in accordance with Canadian GAAP.

The consolidated financial statements were approved by the Board of Directors for issue on February 22, 2012.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATION UNCERTAINTY

### Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for investments in debt and equity securities, and derivatives, which are measured at fair value.

### Basis of preparation

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed below under the heading "Significant judgments and estimates".

The estimates and underlying assumptions are reviewed on an ongoing basis. Changes in accounting estimates are recognized in the period in which the estimate is revised and in future periods if affected.

The following accounting policies have been applied consistently to all periods presented in the consolidated financial statements.

### Basis of consolidation and business combinations

The consolidated financial statements comprise the financial statements of Leisureworld Senior Care Corporation and its subsidiaries. The financial statements of the subsidiaries are prepared for the same reporting periods as the parent company, using consistent accounting policies.

The acquisition method of accounting is used to account for the acquisitions of subsidiaries. Total consideration on the acquisition is measured as the fair value of the assets transferred and equity instruments issued on the date of the acquisition. Transaction costs related to the acquisition are expensed as incurred. Identifiable assets acquired and liabilities assumed are measured at their fair value at the date of acquisition. The excess of fair value of consideration transferred above the fair value of the identifiable net assets acquired is recorded as goodwill, with any negative goodwill being recognized in the consolidated statement of operations on the acquisition date.

Subsidiaries are 100% owned and fully controlled by the Company. Subsidiaries are consolidated in these financial statements from the date of acquisition where control is transferred to the group and continue to be consolidated until the date where the Company no longer controls the subsidiary.

All intercompany balances, transactions and unrealized gains and losses arising from intercompany transactions, are eliminated on consolidation.

### Revenue recognition

Revenues include amounts earned from the operation of LTC homes, retirement residences and independent living facilities, PHCS and management fees associated with the operation of Spencer House Inc. A significant portion of the revenues are funded by the Ministry of Health and Long-Term Care (“MOHLTC”). Revenue is recognized in the period in which the services are rendered.

Long-term care revenue  Ontario’s LTC sector is regulated by the MOHLTC, which provides government funding to LTC homes. Operational funding, paid monthly, is divided into three envelopes: nursing; programs; and other accommodations, which includes funding for raw food. Revenue for nursing, programs and raw food is only recognized to the extent that an eligible expense has been incurred. All envelope funding received that is not spent is recorded as a government funding payable. The non-raw food portion of the other accommodation funding is recognized as earned in the month of receipt. Approximately 70% of revenue from Leisureworld’s LTC homes is received from the MOHLTC. Leisureworld also receives structural compliance premiums from the MOHLTC on a per resident per day basis. Additionally, the MOHLTC provides funding to Leisureworld LTC homes that have been accredited and reimburses up to 85% of property tax costs.

Revenue for accommodation fees are recognized based on the number of resident days in the period multiplied by the per diem amounts legislated by the MOHLTC. Revenue for each LTC home is recognized based on full occupancy, unless there is an indication that the annualized occupancy rate will fall below 97% at which point revenue will be adjusted. Effective for January 1, 2011, the MOHLTC has introduced an interim measure for homes with occupancy rates above 85% and lower than 97%. The funding will be equal to actual occupancy rate plus an additional 3%. Prior to January 1, 2011, if occupancy rate was below 97%, then revenue was recognized based on actual occupancy rate. Other LTC revenues paid by the residents relating to accommodation fees and ancillary services are recognized in the period in which the services are rendered.

Retirement residence and independent living revenue Residents pay for accommodation rates and other services on a monthly basis and revenue is recorded when the service is rendered.

PHCS revenue Revenue associated with PHCS is recognized when the services are rendered. Revenue generated from providing services to other operating segments of the Company is eliminated upon consolidation.

Spencer House Inc. revenue Spencer House Inc. is a charitable organization that owns a licence to operate an LTC home in Orillia, Ontario. A subsidiary of the Company owns the land, building and equipment used by the home and has been contracted to manage the operations of Spencer House Inc. The Company earns rental income from leasing the land, building and equipment to Spencer House Inc. as well as a management fee based on a percentage of gross revenues of the operation for managing the home. Revenue is recognized when the services are rendered.

### Construction funding

The MOHLTC provides funding to homes constructed after April 1, 1998. Under the development agreements, these homes received a 20-year commitment from the MOHLTC to provide per diem funding of up to $10.35 per bed, depending on actual construction costs. The construction funding receivable is measured at amortized cost using the effective interest method. The fair value will differ from the carrying value due to changes in interest rates.

### Income support

Income support is comprised of a $5,500 three-year income support agreement held in escrow as an income guarantee to supplement cash flow from the Royale properties during the lease-up period. The amount drawn down each month is equivalent to the stabilized after tax Net Income from Operations (“NOI”) targets, as defined by the purchase and sale agreement, after a management fee less actual after tax NOI.

### Property and equipment

Property and equipment are recorded at cost less accumulated depreciation and accumulated impairment losses. Costs include expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset’s carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the consolidated statement of operations during the period in which they are incurred.

The Company provides for depreciation at rates designed to depreciate the cost of the property and equipment less the estimated residual value over the estimated useful lives. The annual depreciation rates and methods are as follows:

| | |
|---|---|
| Buildings | Up to 55 years straight-line |
| Furniture and fixtures | 10 years straight-line |
| Computer hardware | 5 years straight-line |
| Circulating equipment | Not depreciated |

Circulating equipment is comprised of china, linen, glassware and silverware in circulation, which is valued at cost. The cost of acquiring a basic inventory of these items is capitalized and any replacements incurred thereafter are expensed.

The Company allocates the initial cost of an item of property and equipment to its significant parts and depreciates separately each such part. Residual values, method of depreciation and useful lives of the assets are reviewed at least annually and adjusted if appropriate. Gains and losses on disposals of property and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of operating expenses in the consolidated statement of operations.

### Intangible assets

Intangible assets include LTC licences, service contracts, resident relationships and computer software that is not integral to computer hardware included in property and equipment. Intangible assets with finite useful lives are amortized over their respective estimated useful lives and reviewed for impairment at each consolidated statement of financial position date or if there is an indicator of impairment. The annual amortization rates and methods are as follows:

| | |
|---|---|
| Licences | Not amortized |
| Resident relationships | 2–3 years straight-line |
| Service contracts | 3 years straight-line |
| Computer software – primarily HRIS | 5 years straight-line |

The Company incurs costs associated with the design, development and implementation of a new Human Resource Information System (“HRIS”); such costs are classified as computer software as they are not integral to property and equipment. Expenditures incurred during the research phase were expensed as incurred. Expenditures incurred during the development phase are capitalized if certain criteria, including technical feasibility and intent and ability to develop and use the technology, are met; otherwise, they are expensed as incurred. HRIS will be amortized over its estimated useful life of five years once put into service.

### Goodwill

Goodwill represents amounts arising on the acquisition of subsidiaries, which is the excess of the purchase consideration over the fair values attributable to the net identifiable assets acquired.

Goodwill is tested for impairment in the second quarter of each year or more frequently when there is an indicator of impairment, and is carried at cost less accumulated impairment losses. Goodwill is not amortized and impairment losses are not reversed. Goodwill is allocated to cash-generating units (“CGUs”) for the purpose of assessing impairment. For the Company, each home, independent living residence, retirement residences and PHCS are separate CGUs. The allocation is made to the CGU, or group of CGUs, that are expected to benefit from the acquisition.

### Impairment of non-financial assets

The Company reviews the carrying amounts of its property and equipment and finite-lived intangible assets at each reporting date to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any. For assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows. Intangible assets with an indefinite useful life are tested for impairment annually in the second quarter of each year and whenever there is an indication that the asset may be impaired. Non-financial assets, other than goodwill, that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

### Financial instruments

Financial instruments comprise of cash and cash equivalents, accounts receivable and other assets, construction funding receivable, government funding receivable/payable, annuity, accounts payable and accrued liabilities, long-term debt and interest rate swap contracts. Financial instruments are recognized initially at fair value. The Company’s interest rate swap contracts are measured at fair value and any changes are reflected in the consolidated statement of operations.

### Derivatives

Derivative instruments are used to reduce interest rate risk on the Company’s long-term debt. The Company does not enter into derivative instruments for trading or speculative purposes. Derivative instruments are carried at fair value and are reported as assets where they have a positive fair value and as liabilities where they have a negative fair value. IFRS 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 and cash flow hedges. 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. The change in fair value of an instrument that is determined to be an effective cash flow hedge is recognized in other comprehensive income (loss). The ineffective portion of the change in fair value is recorded in the consolidated statement of operations. The Company has no derivative financial instruments for which hedge accounting has been applied.

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for at fair value when their economic characteristics and risks are not closely related to those of the host contract. The Company has determined that it does not have any outstanding contracts or financial instruments with embedded derivatives that require separation.

### Impairment of financial assets

Financial assets are reviewed at each consolidated statement of financial position date to assess whether there is objective evidence that indicates an impairment of a financial asset. If such evidence exists, the Company recognizes an impairment loss measured at the excess of the carrying amount over the fair value of the asset, which is reflected in the consolidated statement of operations.

### Transaction costs

Transaction costs are incremental costs directly related to the acquisition of a financial asset or the issuance of a financial liability or equity. The Company incurs transaction costs primarily through the issuance of debt or shares, and classifies these costs with the related debt, or as a reduction of the value of the proceeds received for the share issuance. The costs associated with the issuance of debt are amortized into interest expense using the effective interest rate method over the life of the related debt instrument. Incremental costs directly attributable to the issuance of shares are recognized as a reduction of share capital. Transaction costs associated with business acquisitions are expensed as incurred.

### Interest bearing loans and borrowings

All interest bearing loans and borrowings are initially recognized at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, interest bearing loans and borrowings are subsequently measured at their amortized cost using the effective interest method.

### Operating lease payments

Payments made under operating leases are recognized in the consolidated statement of operations on a straight-line basis over the term of the lease.

### Share capital

Common shares are classified as shareholders' equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from shareholders' equity.

### Dividends

Dividends on common shares are recognized in the consolidated financial statements in the period in which the dividends are declared by the Board of Directors of the Company.

### Earnings (loss) per share

Basic earnings (loss) per share ("EPS") is calculated by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants and similar instruments is computed using the treasury stock method. The Company's potentially dilutive common shares comprise unvested shares issued to certain senior executives and are currently anti-dilutive.

### Share-based compensation

The Company issued shares to certain senior executives. These shares vest over three years (33% per year). Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. Fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over each tranche's vesting period by increasing share capital.

### Employee benefits

Short-term benefits Short-term employee benefit obligations, including vacation and bonus payments, are measured on an undiscounted basis and are expensed as the related service is provided. Assuming the obligation can be reasonably estimated, liabilities are recognized for the amounts expected to be paid within the fiscal 12 months as the Company has an obligation to pay the amount as a result of past service provided by the employee. These benefits are recorded in accounts payable and accrued liabilities.

Long-term benefits Payments to defined contribution retirement benefit plans are charged to expense as earned.

### Income taxes

The Company follows the asset and liability method of accounting for income taxes. Income taxes comprise of current and deferred taxes. Income taxes are recognized in the consolidated statement of operations except to the extent that it relates to items recognized directly in shareholders' equity. Income tax balances are also recorded on initial recognition of a deferred tax asset or liability acquired in a business combination.

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

In general, deferred taxes are recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred taxes were also recognized on the acquisition of the Royale properties. Deferred taxes are determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the consolidated statement of financial position date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent it is probable that the assets can be recovered.

Deferred income tax assets and liabilities are presented as non-current.

The carrying amount of deferred tax assets is reviewed at each consolidated statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset. This applies when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

### Segmented reporting

The Company operates solely within Canada, hence no geographical segment disclosures are presented. Segmented information is presented in respect of business segments, based upon management's internal reporting structure. Further details are provided in Note 26.

### Accounting standards issued but not yet applied

IFRS 9, Financial Instruments IFRS 9, Financial Instruments, addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39, Financial Instruments – Recognition and Measurement, that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the consolidated statement of operations, unless this creates an accounting mismatch. IFRS 9 is required to be applied for accounting periods beginning on or after January 1, 2015, with earlier adoption permitted. The Company has decided not to early adopt this standard.

IFRS 10, Consolidated Financial Statements IFRS 10, Consolidated Financial Statements, changes the definition of control under IFRS so that the same criteria are applied to all entities to determine control. IFRS 10 supersedes the guidance on control and consolidation in IAS 27, Consolidated and Separate Financial Statements, and SIC-12, Consolidation – Special Purpose Entities. The future accounting policy changes are effective for annual periods beginning on or after January 1, 2015 with early adoption permitted. The Company has decided not to early adopt this standard.

IFRS 13, Fair Value Measurement IFRS 13, Fair Value Measurement, provides a single source of guidance on how to measure fair value where its use is already required or permitted by other IFRS and enhances disclosure requirements for information about fair value measurements. The future accounting policy changes are effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has decided not to early adopt this standard.

There are no other accounting standards issued but not yet applied that would be expected to have a material impact on the Company.

**Significant judgments and estimates**

The preparation of the consolidated financial statements under IFRS requires the Company to make estimates and assumptions that affect the application of policies and reported amounts. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events, that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The estimates and assumptions which have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities are discussed below.

**Property and equipment**

(i) Fair value On March 23, 2010, the Company indirectly purchased Leisureworld Senior Care LP. As part of this transaction, the property and equipment was recorded at its fair value. The total fair value attributed to the property and equipment was $299,639.

On April 27, 2011, The Royale LP acquired two RRs comprising 294 suites located in Kingston and Kanata, Ontario. As part of this transaction, the property and equipment was recorded at its fair value. The total fair value attributed to the property and equipment was $85,829.

(ii) Estimated useful lives Management estimates the useful lives of property and equipment based on the period during which the assets are expected to be available for use. The amounts and timing of recorded expenses for depreciation of property and equipment for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of technical or commercial obsolescence and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company’s property and equipment in the future.

(iii) Residual value Management estimates the residual value of property and equipment based on current market prices of similar assets. The estimates are reviewed at least annually and are updated if expectations change as a result of permanent market changes or technical or commercial obsolescence. It is possible that changes in these factors may cause significant changes in the carrying value of the Company’s property and equipment in the future.

**Intangible assets**

(i) Fair value On March 23, 2010, the Company indirectly purchased Leisureworld Senior Care LP. As part of this transaction, the intangible assets were recorded at its fair value. The total fair value attributed to the intangible assets was $106,466.

On April 27, 2011, the Kingston and Kanata RRs were acquired by The Royale LP. As part of this transaction, the intangible assets were recorded at its fair value. The total fair value attributed to the intangible assets was $4,777.

(ii) Estimated useful lives of finite-lived intangible assets Management estimates the useful lives of finite-lived intangible assets based on the period during which the assets are expected to be available for use. The amounts and timing of recorded expenses for amortization of intangible assets for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of technical or commercial obsolescence and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's finite-lived intangible assets in the future.

(iii) Indefinite-lived intangible assets In the Province of Ontario, all LTC homes are funded and must be licensed. The Long-Term Care Homes Act, 2007 ("LTCHA") was proclaimed into law and became effective July 1, 2010. The LTCHA contains a new licence term regime that will result in licence terms for the Leisureworld homes ranging from 15 years for Class B and C homes to a minimum of 20 years for Class A homes. Previously, Ontario LTC licences were renewed annually by the MOHLTC. Under the LTCHA, ultimate control of LTC licences in Ontario remains with the MOHLTC, including approval of new licences and transfer or revocation of existing licences. With an existing wait-list of more than 20,000 in Ontario and the demand for LTC beds projected to increase, management is of the view that licences continue to have indefinite lives and will not be amortized.

Goodwill and indefinite-lived intangible asset impairment analysis On an annual basis, in the second quarter, the Company uses forecast cash flow information and estimates of future growth to assess whether goodwill and indefinite-lived intangible assets are impaired. If the results of operations in a future period are adverse to the estimates used for impairment testing, an impairment charge may be triggered at that point, or a reduction in useful economic life may be required. Any impairment losses are recognized in the consolidated statement of operations as an expense. Impairment losses on goodwill are not reversible.

Share-based compensation The assumptions used in calculating the fair value of share-based compensation have a significant impact upon the amount of the charge recognized in the consolidated statement of operations. Details of the principal assumptions used in calculating the share-based compensation expense are given in Note 17. When a grant of share awards is made, management reviews the estimates and assumptions used to ensure appropriateness.

Deferred taxes Deferred tax assets and liabilities require management's judgment in determining the amounts to be recognized. In particular, judgment is used when assessing the extent to which deferred tax assets should be recognized with consideration to the timing and level of future taxable income.

Income taxes The actual tax on the results for the period is determined according to complex tax laws and regulations. Where the effect of these laws and regulations is unclear, estimates are used in determining the liability for tax to be paid on past profits which are recognized in the consolidated financial statements. The Company considers the estimates, assumptions and judgments to be reasonable but this can involve complex issues which may take a number of years to resolve. The final determination of prior year tax liabilities could be different from the estimates reflected in the consolidated financial statements.

## 4. TRANSITION TO IFRS

The effect of the Company's transition to IFRS, described in Note 2, is summarized in this note as follows:

(a) Reconciliation of shareholders' equity as previously reported under Canadian GAAP to IFRS; and

(b) Reconciliation of net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS.

It should be noted that since the Company was formed on February 10, 2010, the transition elections in accordance with IFRS 1 are not applicable.

**(a) Reconciliation of shareholders' equity as previously reported under Canadian GAAP to IFRS**

| | Notes | December 31, 2010 |
|---|---|---|
| **Shareholders' equity as reported under Canadian GAAP** | | 171,158 |
| IFRS adjustments increase (decrease): | | |
| Property and equipment | (i) | (4,226) |
| Acquisition related costs | (ii) | (35) |
| Deferred income taxes | (iii) | 1,294 |
| | | (2,967) |
| **Shareholders' equity as reported under IFRS** | | **168,191** |

(i) Property and equipment Under IFRS, the significant individual components of property and equipment with different useful lives are required to be separately identified and measured whereas management had not determined components under Canadian GAAP at the time of acquisition of the assets. The changes in property and equipment relate to differences in depreciation of the property and equipment which were impacted by componentization.

(ii) Acquisition related costs In accordance with Canadian GAAP, costs directly attributable to an acquisition are capitalized. Under IFRS, these costs are required to be expensed.

(iii) Deferred income taxes The change in shareholders' equity related to deferred income taxes reflect the change in temporary differences resulting from the effect of the IFRS adjustments described in 4(a)(i) and 4(a)(ii) above.

**(b) Reconciliation of net loss and comprehensive loss as previously reported under Canadian GAAP to IFRS**

| | Notes | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|
| **Net loss and comprehensive loss as reported under Canadian GAAP** | | (4,132) |
| IFRS adjustments increase (decrease): | | |
| Property and equipment | (i) | (4,226) |
| Acquisition related costs | (ii) | (35) |
| Deferred income taxes | (iii) | 1,294 |
| | | (2,967) |
| **Net loss and comprehensive loss as reported under IFRS** | | (7,099) |

(i) Property and equipment As described in 4(a)(i), the changes in property and equipment relate to differences in depreciation of the property and equipment, which were impacted by componentization under IFRS.

(ii) Acquisition related costs As described in 4(a)(ii), costs related to acquisitions are required to be expensed as incurred under IFRS.

(iii) Deferred income taxes Deferred income taxes are impacted by the change in temporary differences resulting from the effect of the IFRS reconciling items described in 4(b)(i) and 4(b)(ii) above.

Upon conversion to IFRS, the consolidated statement of cash flows for the period ended December 31, 2010 has been adjusted to reflect changes in the classification of net financing charges from operating activities to financing activities.

## 5. FINANCIAL INSTRUMENTS

Financial instruments consist of cash and cash equivalents, accounts receivable and other assets, construction funding receivable, government funding receivable/payable, annuity, accounts payable and accrued liabilities, long-term debt and interest rate swap contracts.

### Cash and cash equivalents

Cash includes deposits held with Canadian chartered banks. Cash equivalents are short-term investments with an initial maturity of less than three months. Cash and cash equivalents are classified as held-for-trading. The carrying value of cash and cash equivalents approximates fair value as they are immediately available for use.

### Accounts receivable and other assets

Accounts receivable and other assets are classified as loans and receivables. Accounts receivable and other assets are initially recorded at fair value and subsequently recognized at amortized cost. The carrying value of accounts receivable and other assets, after consideration of the provision for doubtful accounts, approximates their fair value due to the short-term maturity of these instruments.

### Construction funding receivable

The construction funding receivable is classified as loans and receivables. The construction funding receivable is initially recorded at fair value and subsequently measured at amortized cost using the effective interest method. The fair value will differ from the carrying value due to changes in interest rates.

### Annuity

The annuity was classified as loans and receivables. The annuity was initially recorded at fair value and subsequently measured at amortized cost using the effective interest method. The fair value will differ from the carrying value due to changes in interest rates.

### Accounts payable and accrued liabilities

Accounts payable and accrued liabilities are classified as other liabilities. Accounts payable and accrued liabilities are initially recorded at fair value and subsequently measured at amortized cost, which approximates fair value due to the short-term maturity of the instruments.

### Long-term debt

The Company's long-term debt is initially recorded at fair value and subsequently measured at amortized cost using the effective interest method and is classified as other liabilities. The fair value of the Company's long-term debt is subject to changes in interest rates and the Company's credit rating.

### Government funding receivable/payable

The government funding balances are classified as either other loans and receivables or liabilities which are measured at amortized cost. Government funding receivable/payable represents the difference between the amounts earned and those received from the MOHLTC, which are non-interest bearing. The carrying value of the government funding approximates its fair value. The difference between the carrying value and the fair value of the long-term portion is insignificant.

### Interest rate swap contracts

The Company has interest rate swap contracts for which hedge accounting has not been applied. The changes in fair value are recorded in the consolidated statement of operations.

### Fair value of financial instruments

The fair value of a financial instrument is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. When independent prices are not available, fair values are determined using valuation techniques that refer to observable market data. These techniques include comparisons with similar instruments where market observable prices exist, discounted cash flow analysis, and other valuation techniques commonly used by market participants. Fair values of long-term debt, interest rate swap contracts and construction funding receivable are calculated by discounted cash flow analysis based on current market rates for loans and investments with similar terms, conditions and maturities.

The following tables provide a summary of the carrying and fair values for each classification of financial instrument:

| | Carrying value as at December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | **Assets/ liabilities at fair value through the profit and loss** | **Loans and receivables** | **Other liabilities** | **Total carrying value** | **Fair value** |
| **Financial Assets:** | | | | | |
| **Cash and cash equivalents** | **21,921** | **–** | **–** | **21,921** | **21,921** |
| **Accounts receivable and other assets** | **–** | **5,564** | **–** | **5,564** | **5,564** |
| **Government funding receivable** | **–** | **2,603** | **–** | **2,603** | **2,603** |
| **Construction funding receivable** | **–** | **75,154** | **–** | **75,154** | **82,178** |
| **Financial Liabilities:** | | | | | |
| **Accounts payable and accrued liabilities** | **–** | **–** | **35,331** | **35,331** | **35,331** |
| **Government funding payable** | **–** | **–** | **7,773** | **7,773** | **7,773** |
| **Long-term debt** | **–** | **–** | **355,399** | **355,399** | **383,169** |
| **Interest rate swap contracts** | **892** | **–** | **–** | **892** | **892** |

| | Carrying value as at December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Assets/ liabilities at fair value through the profit and loss | Loans and receivables | Other liabilities | Total carrying value | Fair value |
| Financial Assets: | | | | | |
| Cash and cash equivalents | 14,618 | – | – | 14,618 | 14,618 |
| Accounts receivable and other assets | – | 3,687 | – | 3,687 | 3,687 |
| Government funding receivable | – | 2,800 | – | 2,800 | 2,800 |
| Construction funding receivable | – | 80,575 | – | 80,575 | 82,105 |
| Financial Liabilities: | | | | | |
| Accounts payable and accrued liabilities | – | – | 32,967 | 32,967 | 32,967 |
| Government funding payable | – | – | 6,411 | 6,411 | 6,411 |
| Long-term debt | – | – | 298,496 | 298,496 | 320,593 |
| Interest rate swap contract | 208 | – | – | 208 | 208 |

Impairment charges on accounts receivable are disclosed below. All finance income and costs from financial instruments has been disclosed in Note 12.

All amounts are in thousands of dollars except share and per share data, or unless otherwise noted.

### MATURITIES OF FINANCIAL INSTRUMENTS

For the years ending December 31, 2012 through 2016, and thereafter, Leisureworld has estimated that the following undiscounted cash flows will arise from its interest rate swap contracts, construction funding receivable and long-term debt at the consolidated statement of financial position date:

As at December 31, 2011

| | 2012 | 2013 | 2014 | 2015 | 2016 | Thereafter |
|---|---|---|---|---|---|---|
| **Interest rate swap contracts** | | | | | | |
| **Cash inflows** | **604** | **188** | **–** | **–** | **–** | **–** |
| **Cash outflows** | **(1,292)** | **(392)** | **–** | **–** | **–** | **–** |
| | **(688)** | **(204)** | **–** | **–** | **–** | **–** |
| **Construction funding receivable** | | | | | | |
| **Cash inflows** | **8,554** | **8,532** | **8,532** | **8,532** | **8,554** | **50,643** |
| **Long–term debt** | | | | | | |
| **Cash outflows** | **(16,723)** | **(70,373)** | **(14,923)** | **(324,923)** | **–** | **–** |
| **Net cash inflows (outflows)** | **(8,857)** | **(62,045)** | **(6,391)** | **(316,391)** | **8,554** | **50,643** |

#### Nature and extent of risks arising from financial instruments

The following discussion is limited to the nature and extent of risks arising from financial instruments. The Company's normal operating, investing and financing activities expose it to a variety of financial risks including interest rate risk, credit risk and liquidity risk. Leisureworld is not exposed to foreign currency risk as all operations are in Canada and all purchases are contracted in Canadian dollars. The Company does not have significant exposure to price risk as most of its revenues are regulated by the MOHLTC. The Company's overall risk management process is designed to identify, manage and mitigate business risk, which includes financial risk.

Interest rate risk Interest rate risk arises as the fair value of future cash flows from a financial instrument can fluctuate because of changes in market interest rates. Leisureworld is exposed to interest rate risk arising from fluctuations in interest rates in connection with its interest rate swap contracts. An interest rate swap contract was purchased as part of the LSCLP acquisition and related to a hedge on anticipated borrowings for a transaction that did not occur. Leisureworld is also subject to interest rate risk on variable rate debt issued as a part of the acquisition of the Royale properties. The floating interest rate on the debt is offset by an interest rate swap contract. Leisureworld has not adopted hedge accounting for the interest rate swap contracts. Interest rates, maturities and security affecting the interest and credit risk of Leisureworld's financial assets and liabilities have been disclosed in Notes 12 and 13.

The Company's credit facilities are, and future borrowings may be, at variable rates of interest, which exposes the Company to the risk of increased interest rates.

Credit risk Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents, accounts receivable and other assets, construction funding receivable, government funding receivable and interest rate swap contracts. The Company is exposed to credit risk from its residents and customers. However, the Company has a significant number of residents and customers, which minimizes concentration of credit risk. The credit risk related to amounts owed by the residents is further mitigated by the Company's ability to recover 50% of LTC amounts written off from the MOHLTC. A provision for management's estimate of uncollectible accounts receivable is established when there is objective evidence the Company will not be able to collect all amounts due. The Company assesses collectability of specific accounts receivable and also assesses the requirement for a provision based on historical experience. The amount of the provision is reduced by amounts that would be recovered from the MOHLTC upon ultimate write-off. When a receivable is uncollectible, it is written off against the allowance for doubtful accounts. Subsequent recoveries of amounts previously written off are credited against operating expenses in the consolidated statement of operations.

The continuity of the allowance for doubtful accounts is as follows:

| | |
|---|---|
| Balance, February 10, 2010 | – |
| Acquired on acquisition of LSCLP (Note 7) | 869 |
| Provision for receivables during the period | 129 |
| Receivables written off during the period | (234) |
| Balance, December 31, 2010 | 764 |
| Provision for receivables during the year | – |
| Receivables written off during the year | (35) |
| **Balance, December 31, 2011** | **729** |

The Company has $3,218 in trade and other receivables (December 31, 2010 – $2,492) that are past due but not impaired. These amounts have not been provided for as there has not been a significant change in the credit quality and the amounts are still considered recoverable. The Company does not hold any collateral over these balances.

The aging analysis of these receivables is as follows:

| | **December 31, 2011** | December 31, 2010 |
|---|---|---|
| 0–30 days | **1,719** | 1,292 |
| 31–60 days | **366** | 386 |
| 61–90 days | **176** | 116 |
| Over 90 days | **957** | 698 |

The Company is also exposed to credit risk through the amounts receivable from the MOHLTC. The Company has assessed the credit risk associated with the amounts owed by the MOHLTC as low as they are receivable from the Ontario government. Management has assessed the credit risks associated with the interest rate swap contracts and cash and cash equivalents balances as low given the counter parties are major Canadian financial institutions that have been accorded investment grade ratings by a primary rating agency.

Liquidity risk Liquidity risk is the risk the Company may encounter difficulties in meeting its obligations associated with financial liabilities and commitments. The Company has credit agreements in place related to the long-term debt. These credit agreements contain a number of standard financial and other covenants. A failure by the Company to comply with the obligations in these credit agreements could result in a default, which, if not rectified or waived, could permit acceleration of the relevant indebtedness.

The Company maintains a capital structure, including access to a revolving credit facility of $10,000, which helps to manage the risk of default under these credit agreements.

**Sensitivity analysis**

IFRS requires disclosure of a sensitivity analysis that is intended to illustrate the sensitivity of the Company's financial position, performance and fair value of cash flows associated with the Company's financial instruments to changes in market variables (i.e. interest rates). The sensitivity analysis provided discloses the effect on the consolidated statement of operations at December 31, 2011 assuming that a reasonably possible change in the relevant risk variable has occurred at December 31, 2011. The reasonably possible changes in market variables used in the sensitivity analysis were determined based on implied volatilities where available or historical data.

All amounts are in thousands of dollars except share and per share data, or unless otherwise noted.

The sensitivity analysis has been prepared based on December 31, 2011 balances and on the basis that the balances, the ratio of fixed to floating rates of debt and the derivatives at December 31, 2011 are all constant. Excluded from this analysis are all non-financial assets and liabilities that are not classified as financial instruments.

The sensitivity analysis provided is hypothetical and should be used with caution as the impacts provided are not necessarily indicative of the actual impacts that would be experienced as the Company's actual exposure to market rates may change. Changes in fair values or cash flows based on a variation in a market variable cannot be extrapolated because the relationship between the change in the market variable and the change in fair value or cash flows may not be linear. In addition, the effect of a change in a particular market variable on fair values or cash flows is calculated without considering interrelationships between the various market rates or mitigating actions that would be taken by the Company.

| | | | Interest rate risk | |
|---|---|---|---|---|
| | | | -1% | +1% |
| | Notes | Carrying value | Income | Income |
| **Financial Assets:** | | | | |
| Cash and cash equivalents | 8 | 21,921 | (116) | 173 |
| **Financial Liabilities:** | | | | |
| Interest rate swap contracts | 12 | (892) | (732) | 732 |

The Company currently has no net cash flow risk associated with changes in interest rates. Any changes in the interest payable under the debt issued as part of the acquisition of the Royale properties would be offset by a change in the cash flows from the related swap contract.

### Fair value hierarchy

Financial instruments carried at fair value have been categorized under the three levels of fair value hierarchy as follows:

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities This level of the hierarchy includes cash and cash equivalents. The fair value of the instrument is based on quoted prices where the prices represent those at which regularly and recently occurring transactions take place.

Level 2: Inputs that are observable for the assets or liabilities either directly or indirectly This level of the hierarchy includes the interest rate swap contracts. These instruments are recorded at fair value as of each reporting date. The fair value of the interest rate swap contracts are calculated through discounting future expected cash flows using the bankers' acceptance ("BA") based swap curve. Since the BA based swap curve is an observable input, these financial instruments are considered Level 2.

Level 3: Inputs for assets or liabilities that are not based on observable market data The Company does not have any financial instruments in this level.

| | Financial instruments at fair value as of December 31, 2011 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **Financial Assets:** | | | | |
| Cash and cash equivalents | 21,921 | – | – | 21,921 |
| **Financial Liabilities:** | | | | |
| Interest rate swap contracts | – | (892) | – | (892) |

| | Financial instruments at fair value as of December 31, 2010 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Financial Assets: | | | | |
| Cash and cash equivalents | 14,618 | – | – | 14,618 |
| Financial Liabilities: | | | | |
| Interest rate swap contracts | – | (208) | – | (208) |

## 6. CAPITAL MANAGEMENT

The Company defines its capital as the total of its long-term debt, shareholders' equity and cash and cash equivalents.

The Company's objectives when managing capital are to: (i) maintain a capital structure that provides financing options to the Company when a financing or a refinancing need arises to ensure access to capital, on commercially reasonable terms, without exceeding its debt capacity; (ii) maintain financial flexibility in order to preserve its ability to meet financial obligations, including debt servicing payments and dividend payments; and (iii) deploy capital to provide an appropriate investment return to its shareholders.

The Company's financial strategy is designed to maintain a flexible capital structure consistent with the objectives stated above and to respond to changes in economic conditions. In order to maintain or adjust its capital structure, the Company may issue additional shares, issue additional long-term debt, issue long-term debt to replace existing long-term debt with similar or different characteristics, or adjust the amount of dividends paid to the Company's shareholders. The Company's financing and refinancing decisions are made on a specific transaction basis and depend on such things as the Company's needs and market and economic conditions at the time of the transaction.

The Board of Directors reviews the level of monthly dividends paid on a quarterly basis.

The Series A Senior Secured Notes ("the 2015 Notes") and revolving credit facility (Note 13) are collateralized by all assets of LSCLP and the subsidiary partnerships totalling $541,428 and guaranteed by the subsidiary partnerships. Under its Master Trust Indenture, LSCLP is subject to certain financial and non-financial covenants including a debt service coverage ratio defined as income from operations and construction funding ("EBITDA") to debt service.

The two-year credit facility ("Bridge Loan") is secured by the assets of Royale guaranteed by the Company and is subject to certain customary financial and non-financial covenants. The Company is in compliance with all financial covenants on its borrowings as of December 31, 2011. However, there can be no assurance future covenant requirements will be met. If the Company does not remain in compliance, its ability to amend the covenants or refinance its debt could be affected.

There were no changes in the Company's approach to capital management during the year.

All amounts are in thousands of dollars except share and per share data, or unless otherwise noted.

## 7. ACQUISITIONS

On March 23, 2010, the Company acquired 100% ownership interest in LSCLP. The acquisition occurred on the date of closing the Company's IPO and through an indirect acquisition the Company acquired all of the outstanding limited partnership interests in LSCLP and the common shares of Leisureworld Senior Care GP Inc., the general partner of LSCLP. Goodwill in the amount of $91,466 was recognized as the difference between the fair value of assets and liabilities acquired and the consideration paid. None of the goodwill recognized is expected to be deductible for tax purposes.

The following table summarizes the consideration paid for LSCLP and the amounts of assets acquired and liabilities assumed that were recognized at the acquisition date.

| **Consideration** | |
|---|---|
| Cash payment to Macquarie Long-Term Care LP | 112,517 |
| Cash payment to Trustee | 95 |
| Non-interest bearing promissory note issued to Macquarie Long-Term Care LP | 9,035 |
| Cash acquired | (14,762) |
| **Total consideration transferred** | **106,885** |

The total purchase price of $121,647 was allocated to the assets and liabilities as follows:

| | |
|---|---|
| **Assets** | |
| Cash | 14,762 |
| Accounts receivable and other assets | 4,222 |
| Prepaid expenses and deposits | 1,045 |
| Due from Leisureworld Senior Care Corporation | 4,469 |
| Government funding receivable | 2,008 |
| Construction funding receivable | 84,394 |
| Annuity | 1,002 |
| Property and equipment | 299,639 |
| Intangible assets – licences | 76,000 |
| Intangible assets – resident relationships | 26,190 |
| Intangible assets – service contracts | 3,080 |
| Intangible assets – software | 1,196 |
| Goodwill | 91,466 |
| **Total assets** | **609,473** |
| **Liabilities** | |
| Accounts payable and accrued liabilities | 37,522 |
| Government funding payable | 11,990 |
| Deferred income tax liabilities, net | 79,092 |
| Long-term debt | 356,937 |
| Interest rate swap contract | 2,285 |
| **Total liabilities** | **487,826** |
| **Net assets acquired** | **121,647** |

The non-cash consideration in the amount of $9,035 was provided by way of a non-interest bearing promissory note to Macquarie Long-Term Care LP. As part of the IPO, the underwriters were granted an overallotment option to purchase an additional 958,649 shares of the Company at $10.00 per share, less the underwriters' fees, within 30 days from the date of the IPO. The promissory note was settled by way of issuance of common shares of the Company as the overallotment option was not exercised within 30 days of the IPO.

LSCLP's revenue and net income recorded for the year ended December 31, 2011 were $284,224 (period ended December 31, 2010 – $213,811) and $6,061 (period ended December 31, 2010 – $3,196), respectively.

On April 27, 2011, Leisureworld completed the acquisition of two luxury retirement residences for the net purchase price paid to the vendors of $88,742 after working capital adjustments and a three-year income support agreement of $5,500 held in escrow as an income guarantee to supplement cash flow from the properties during the lease-up period.

The total purchase price of $88,742 was allocated to the assets and liabilities as follows:

| | |
|---|---|
| **Assets** | |
| Cash | 1 |
| Accounts receivable and other assets | 13 |
| Prepaid expenses and deposits | 19 |
| Property and equipment | 85,829 |
| Intangible assets – resident relationships | 4,777 |
| **Total assets** | **90,639** |
| **Liabilities** | |
| Accounts payable and accrued liabilities | 703 |
| Deferred income taxes | 1,194 |
| **Total liabilities** | **1,897** |
| **Net assets acquired** | **88,742** |

As part of the total purchase consideration for the Kingston and Kanata RRs, Leisureworld put in place a $5,500 three-year income support agreement with the vendor, held in escrow as an income guarantee to supplement cash flow during the lease-up period. For the year ended December 31, 2011, the Company has drawn down $3,105. Leisureworld's RRs will have to comply with the requirements of the Retirement Homes Act as the regulations are phased in over time.

During the quarter ended December 31, 2011, Leisureworld finalized the purchase price allocation related to the acquisition of the two retirement properties. The final allocation of fair value to property and equipment and intangible assets resulted in an increase in property and equipment of $10,215 and deferred tax liability of $1,221, a reduction in intangible assets of $4,223 and goodwill was reduced to $nil. The finalization of working capital resulted in reduction in accounts receivable and other assets of $33 and prepaid expenses and deposits of $65 and an increase in accounts payable and accrued liabilities of $175.

Transaction costs expensed related to the acquisition of the Royale properties for the year ended December 31, 2011 were $2,109.

The Royale LP's revenue and net loss recorded for the period from April 27, 2011 to December 31, 2011 were $5,883 and $3,211, respectively.

If the LSCLP acquisition had taken place on January 1, 2010 and the Royale properties acquisition had taken place on January 1, 2011, the revenue and net loss for the year ended December 31, 2011 are estimated to have been $292,523 and $14,634, respectively. The revenue and net loss respectively for the year ended December 31, 2010 are estimated to have been $272,350 and $8,246.

All amounts are in thousands of dollars except share and per share data, or unless otherwise noted.

## 8. CASH AND CASH EQUIVALENTS

| | December 31, 2011 | December 31, 2010 |
|---|---|---|
| Cash | **16,082** | 10,587 |
| Cash equivalents | **5,839** | 4,031 |
| **Cash and cash equivalents** | **21,921** | 14,618 |

## 9. PROPERTY AND EQUIPMENT

| | Land | Buildings | Furniture and fixtures | Computer hardware | Circulating equipment | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At February 10, 2010 | – | – | – | – | – | – |
| Acquisition of Leisureworld Senior Care LP | 42,271 | 246,777 | 9,366 | 240 | 985 | 299,639 |
| Additions | – | 708 | 201 | 36 | – | 945 |
| At December 31, 2010 | 42,271 | 247,485 | 9,567 | 276 | 985 | 300,584 |
| Acquisition of the Royale properties | 5,760 | 80,023 | 46 | – | – | 85,829 |
| Additions | – | 657 | 139 | 202 | – | 998 |
| **At December 31, 2011** | **48,031** | **328,165** | **9,752** | **478** | **985** | **387,411** |
| **Accumulated depreciation** | | | | | | |
| At February 10, 2010 | – | – | – | – | – | – |
| Charges for the period | – | 10,554 | 1,979 | 84 | – | 12,617 |
| At December 31, 2010 | – | 10,554 | 1,979 | 84 | – | 12,617 |
| Charges for the year | – | 14,966 | 2,319 | 93 | – | 17,378 |
| **At December 31, 2011** | **–** | **25,520** | **4,298** | **177** | **–** | **29,995** |
| **Net book value** | | | | | | |
| At December 31, 2010 | 42,271 | 236,931 | 7,588 | 192 | 985 | 287,967 |
| **At December 31, 2011** | **48,031** | **302,645** | **5,454** | **301** | **985** | **357,416** |

## 10. INTANGIBLE ASSETS

| | Licences | Resident relationships | Service contracts | Computer software | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At February 10, 2010 | – | – | – | – | – |
| Acquisition of Leisureworld Senior Care LP | 76,000 | 26,190 | 3,080 | 1,196 | 106,466 |
| Additions | – | – | – | 872 | 872 |
| At December 31, 2010 | 76,000 | 26,190 | 3,080 | 2,068 | 107,338 |
| Acquisition of the Royale properties | – | 4,777 | – | – | 4,777 |
| Additions | – | – | – | 575 | 575 |
| **At December 31, 2011** | **76,000** | **30,967** | **3,080** | **2,643** | **112,690** |
| **Accumulated amortization** | | | | | |
| At February 10, 2010 | – | – | – | – | – |
| Charges for the period | – | 10,144 | 795 | 90 | 11,029 |
| At December 31, 2010 | – | 10,144 | 795 | 90 | 11,029 |
| Charges for the year | – | 14,159 | 1,027 | 102 | 15,288 |
| **At December 31, 2011** | **–** | **24,303** | **1,822** | **192** | **26,317** |
| **Net book value** | | | | | |
| At December 31, 2010 | 76,000 | 16,046 | 2,285 | 1,978 | 96,309 |
| **At December 31, 2011** | **76,000** | **6,664** | **1,258** | **2,451** | **86,373** |

## 11. GOODWILL

| | |
|---|---|
| Cost and carrying value, at February 10, 2010 | – |
| Acquisition of Leisureworld Senior Care LP | 91,466 |
| **Cost and carrying value, at December 31, 2010 and 2011** | **91,466** |

Goodwill acquired in business combinations is allocated to the CGUs that are expected to benefit from that business combination based on the relative fair value of the CGU at the time of acquisition. CGUs are the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The Company has determined that each LTC home, independent living residence, retirement residences and PHCS are separate CGUs for goodwill impairment testing purposes. The Company also allocates indefinite lived intangible assets which relate to the LTC business to the LTC CGUs on a per bed basis. The Company has allocated $91,466 and $76,000 of goodwill and indefinite lived intangible assets, respectively to the individual CGUs. No CGU has been allocated a significant amount of goodwill or indefinite lived intangible assets as compared with the other CGUs. The Company tests goodwill annually during the second quarter for impairment, or more frequently if there are indications that goodwill might be impaired. An impairment loss is recognized if the carrying value of a CGU exceeds its recoverable amount.

The recoverable amount of the CGU is the higher of its value in use and fair value less costs to sell ("fair value"). Fair value is determined as the present value of the estimated future cash flows expected to arise from the continued use of the asset, including any expansion prospects, and its eventual disposal. These cash flows are discounted to arrive at the recoverable amount. In assessing fair value, the estimated future cash flows are derived from the most recent financial budget and long-range forecasts including an assumed growth rate. For the 2011 annual goodwill impairment analysis, the Company used an average post-tax discount rate of approximately 6.25% across the CGUs and an average growth rate of 2% before considering expansion projects. The Company has not recognized any impairment losses.

All amounts are in thousands of dollars except share and per share data, or unless otherwise noted.

## 12. LONG-TERM DEBT

| | Interest rate | Maturity date | December 31, 2011 | December 31, 2010 |
|---|---|---|---|---|
| Series A Senior Secured Notes | 4.814% | November 24, 2015 | **300,599** | 298,496 |
| Bridge Loan | Floating | April 26, 2013 | **54,800** | – |
| | | | **355,399** | 298,496 |

The 2015 Notes represent 4.814% Series A Senior Secured Notes due November 24, 2015 which have a face value of $310,000 and are collateralized by the assets of LSCLP and its subsidiary partnerships and guaranteed by the subsidiary partnerships.

The 2015 Notes may be redeemed in whole or in part at the option of the Company at any time, upon not less than 30 days' and not more than 60 days' notice to the holders of the 2015 Notes. The redemption price is the greater of: (i) the face amount of the 2015 Notes to be redeemed; and (ii) the price that will provide a yield to the remaining average life of such 2015 Notes equal to the Canada Yield Price plus 0.18%, in each case together with accrued and unpaid interest. The Canada Yield Price is defined as a price equal to the price of the debenture calculated to provide an annual yield to maturity equal to the Government of Canada Yield plus 0.25%. Interest on the 2015 Notes is payable semi-annually in arrears on May 24 and November 24 of each year.

On April 27, 2011, the Company entered into the Bridge Loan for $55,000 to finance the acquisition of the Royale properties, which bears interest at 187.5 basis points ("bps") per annum over the floating 30-day BA rate. The Bridge Loan is secured by the assets of Royale and guaranteed by the Company and is subject to certain customary financial and non-financial covenants. The Company, in conjunction with the Bridge Loan, entered into an interest rate swap contract to effectively fix the interest rate at 4.045%. Interest on the Bridge Loan is payable in advance every 30 days beginning on April 30, 2011. As a part of the Bridge Loan, the Company incurred financing costs of $299, directly associated with obtaining the financing. These costs have been recorded as a reduction of the total financing received and are expensed over the term of the loan.

Interest expensed on the long-term debt for the year ended December 31, 2011 was $18,175 (period ended December 31, 2010 – $13,169) which includes non-cash interest of $2,103 (period ended December 31, 2010 – $1,559).

The following summarizes the components of net finance charges, in the consolidated statement of operations:

| | Year Ended December 31, 2011 | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|
| **Finance costs** | | |
| Interest expense on long-term debt | **16,072** | 11,610 |
| Interest expense and fees on revolving credit facility | **51** | 79 |
| Accretion of the fair value increment on long-term debt | **2,103** | 1,559 |
| Amortization of deferred financing charges | **99** | – |
| Net settlement payment on interest rate swap contracts | **613** | 229 |
| | **18,938** | 13,477 |
| **Finance income** | | |
| Interest income on construction funding receivable | **3,111** | 2,785 |
| Other interest income | **121** | 58 |
| Annuity | **–** | 4 |
| | **3,232** | 2,847 |
| **Net finance charges** | **15,706** | 10,630 |

## 13. REVOLVING CREDIT FACILITY

LSCLP has a $10,000 revolving credit facility with a Canadian chartered bank which it can access for working capital purposes. This facility is collateralized by the assets of LSCLP and its subsidiary partnerships of $541,428 and guaranteed by the subsidiary partnerships. It bears interest on cash advances at 150 bps per annum over the floating BA rate (30, 60 or 90 days), or at 50 bps per annum over the prime rate and on letters of credit at 150 bps per annum. As at December 31, 2011, the Company had no amounts drawn on this facility (period ended December 31, 2010 – $nil) and no letters of credit outstanding (December 31, 2010 – $68). The amount had been issued to a municipality with respect to outstanding obligations of the Company related to the construction of an LTC home (Note 20). During the year ended December 31, 2011, charges related to standby fees totalled $43 (period ended December 31, 2010 – $73).

## 14. INCOME TAXES

Total income tax recovery for the period can be reconciled to the loss in the consolidated statement of operations as follows:

| | **Year Ended December 31, 2011** | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|
| **Loss before income taxes** | **(17,547)** | (9,843) |
| Canadian combined income tax rate | **28.25%** | 31.00% |
| Income tax recovery | **(4,957)** | (3,051) |
| Adjustments to income tax provision: | | |
| Non-deductible items | **119** | 221 |
| Book to filing adjustment | **(739)** | – |
| Other items | **7** | 86 |
| **Income tax recovery** | **(5,570)** | (2,744) |

The following are the major deferred tax assets (liabilities) recognized by the Company and movements thereon during the period:

| | Accelerated tax depreciation | Intangible assets | Share issuance | Construction funding interest | Other | Total |
|---|---|---|---|---|---|---|
| As at February 10, 2010 | | | | | | |
| Due to acquisition of LSCLP | (62,320) | (17,986) | – | 6,206 | (4,992) | (79,092) |
| Credit (charge) to net loss | 2,516 | 3,394 | (744) | (881) | 381 | 4,666 |
| Credit to equity | – | – | 4,200 | – | – | 4,200 |
| As at December 31, 2010 | (59,804) | (14,592) | 3,456 | 5,325 | (4,611) | (70,226) |
| Due to acquisition of the Royale properties | (2,612) | 1,418 | – | – | – | (1,194) |
| Credit (charge) to net loss | 3,721 | 4,161 | (983) | (726) | 582 | 6,755 |
| Credit to equity | – | – | 537 | – | – | 537 |
| **As at December 31, 2011** | **(58,695)** | **(9,013)** | **3,010** | **4,599** | **(4,029)** | **(64,128)** |

All amounts are in thousands of dollars except share and per share data, or unless otherwise noted.

The following chart details the reversal of the recognized deferred tax liabilities.

| | **December 31, 2011** | December 31, 2010 |
|---|---|---|
| Within one year | **(2,202)** | (4,988) |
| One to four years | **(9,616)** | (10,445) |
| After four years | **(52,310)** | (54,793) |
| Total | **(64,128)** | (70,226) |

## 15. SHARE CAPITAL

### Authorized

Unlimited number of common shares without nominal or par value

### Issued and outstanding

Common shares

| | Common shares | Amount |
|---|---|---|
| Balance, February 10, 2010 | – | – |
| Issued common shares | 19,020,000 | 178,768 |
| Issued common shares in exchange for note payable | 958,649 | 9,035 |
| Share-based compensation (Note 17) | 130,000 | 714 |
| Balance, December 31, 2010 | 20,108,649 | 188,517 |
| Issued common shares | 4,381,500 | 44,394 |
| Share-based compensation (Note 17) | – | 296 |
| **Balance, December 31, 2011** | **24,490,149** | **233,207** |

During the period ended December 31 2010, the Company issued 19,020,000 shares for proceeds of $178,768, net of underwriters' fees of $10,937, other IPO related costs of $4,695 and the related future tax impact of $4,200. The number of shares above includes 66,667 shares that have not fully vested in accordance with the share-based compensation agreement (Note 17). In addition, 958,649 shares were issued to settle a note payable of $9,035.

On April 27, 2011, the Company raised $44,394, net of underwriters' fees and other issuance related costs of $2,148, and the related deferred tax impact of $537, through a public offering of 4,381,500 common shares.

There are 66,667 unvested common shares that are outstanding (Note 17) that are anti-dilutive.

## 16. DIVIDENDS

The Company paid dividends at $0.0708 per month per common share totalling $19,565 for the year ended December 31, 2011 (period ended December 31, 2010 – $11,803). Dividends of $1,734 are included in accounts payable and accrued liabilities as of December 31, 2011 (December 31, 2010 – $1,424). Subsequent to December 31, 2011, the Board of Directors declared dividends of $0.0708 per common share for January and February 2012 totalling $3,468. These dividends are not included in accounts payable and accrued liabilities.

## 17. SHARE-BASED COMPENSATION

Share-based compensation was introduced by the Company in relation to the IPO, at which time 130,000 shares were awarded to certain key executives. The Company does not have a recurring share-based plan in place.

Of this amount, 30,000 shares were awarded for nominal value and had trading restrictions imposed on them for a period of six months. These shares vested immediately upon issuance. The remaining 100,000 shares vest in three equal installments on the first, second and third anniversary of the grant date and also have trading restrictions imposed. The fair value of these shares was determined to be approximately $1,147 based on the Black-Scholes option pricing model. Share-based compensation expense was $296 for the year ended December 31, 2011 (period ended December 31, 2010 – $714) which was recognized in administrative expenses with a corresponding increase in share capital.

A summary of the movement of the shares granted is as follows:

| | Shares awarded | Weighted average exercise price (dollars) |
|---|---|---|
| Balance, February 10, 2010 | – | N/A |
| Granted | 130,000 | N/A |
| Vested | (30,000) | N/A |
| Unvested, December 31, 2010 | 100,000 | N/A |
| Vested | (33,333) | N/A |
| **Unvested, December 31, 2011** | **66,667** | **N/A** |

The fair value of the shares granted was calculated using the Black-Scholes option pricing model. The assumptions used in the model were as follows:

| | |
|---|---|
| Risk-free rate | 1.42% |
| Exercise price | $0.00 |
| Expected life (in years) | 0–3 |
| Weighted average fair value of shares granted | $8.82 |
| Expected dividend yield | 8.50% |

All amounts are in thousands of dollars except share and per share data, or unless otherwise noted.

## 18. EMPLOYEE BENEFITS

Payroll costs for all employees including key management consist of:

| | **Year Ended December 31, 2011** | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|
| Salaries and short-term employee benefits | **184,899** | 138,533 |
| Post-employment benefits | **4,084** | 3,118 |
| Termination benefits | **343** | 146 |
| Share-based compensation | **296** | 714 |
| | **189,622** | 142,511 |

The Company contributes to certain of its employees' defined contribution pension plans based on 4% of gross wages. The expense associated with these plans for the year ended December 31, 2011 was $4,084 (period ended December 31, 2010 – $3,118).

## 19. KEY MANAGEMENT COMPENSATION

The remuneration of key management is set out below in aggregate for each of the categories specified in IAS 24, Related Party Disclosures.

| | **Year Ended December 31, 2011** | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|
| Salaries and short-term employee benefits | **2,524** | 1,591 |
| Share-based compensation | **296** | 714 |
| | **2,820** | 2,305 |

## 20. COMMITMENTS

As at December 31, 2011, the Company had cancelled its letter of credit outstanding and had no amount owing (December 31, 2010 – $68). The amount had been issued to a municipality with respect to outstanding obligations of the Company related to the construction of an LTC home.

The Company has a ten-year operating lease with respect to its corporate office; the lease expires on December 31, 2015. The Company also has various operating leases for office and other equipment.

Lease payments in respect of the remaining years of the operating leases are as follows:

| | |
|---|---|
| 2012 | 557 |
| 2013 | 520 |
| 2014 | 429 |
| 2015 | 371 |
| 2016 | – |
| Thereafter | – |
| | **1,877** |

On June 22, 2010, the Company announced an agreement to acquire 88 LTC licences from Christie Gardens Apartments and Care Inc., conditional on approval by the MOHLTC. These licences are in the Toronto area and will increase the total number of the Company's LTC beds by approximately 2%. According to the terms of the agreement, the licences will be acquired by March 31, 2013 at a cost of $2,200. No licences were acquired under the terms of this agreement in the year ended December 31, 2011 or the period ended December 31, 2010.

### 21. CONSTRUCTION FUNDING RECEIVABLE

The MOHLTC provides funding to new homes constructed after April 1, 1998. Under the development agreements, these new homes receive a 20-year commitment from the MOHLTC to provide per diem funding of up to $10.35 per bed, depending on actual construction costs. The funding for the remaining terms of the agreements is subject to the condition that the homes continue to operate as long-term care communities for the remaining period. As of December 31, 2011, the condition for the funding has been met. The construction funding receivable is measured at amortized cost using the effective interest method. The fair value will differ from the carrying value due to changes in interest rates.

As at December 31, 2011, the Company will receive gross funding from the Ontario government of approximately $93,347 (2010 – $101,879) related to the construction costs of LTC homes. The amounts are non-interest bearing and will be received for certain LTC homes for various periods ending over the next 15 years.

Included in net finance charges is interest income on the construction funding receivable of $3,111 for the year ended December 31, 2011 (period ended December 31, 2010 – $2,785).

### 22. TRUST FUNDS

The Company maintains separate trust accounts on behalf of its LTC home residents, which are not included in these consolidated financial statements. The total balance in the trust bank accounts as at December 31, 2011 was $957 (2010 – $1,186).

### 23. RELATED PARTY TRANSACTIONS

During the year ended December 31, 2011, the Company earned revenue from Spencer House Inc., a charitable organization that owns a licence to operate an LTC home in Orillia, Ontario. A subsidiary of the Company has been contracted to manage the operations of Spencer House Inc. Total revenue for the year ended December 31, 2011 was $1,899 (period ended December 31, 2010 – $1,410). Included in accounts receivable is $12 owing from Spencer House Inc. at December 31, 2011 (2010 – $53). These transactions are in the normal course of operations and have been valued in these consolidated financial statements at the exchange amount, which is the amount of consideration established and agreed to by the management of the related parties. These amounts are due on demand and are non-interest bearing.

### 24. ECONOMIC DEPENDENCE

The Company holds licences related to each of its LTC homes and receives funding from the MOHLTC related to these licences. Funding is received on or about the 22nd of each month. During the year ended December 31, 2011, the Company received approximately $200,596 (period ended December 31, 2010 – $141,748), in respect of these licences for operating revenues and other MOHLTC funded initiatives.

All amounts are in thousands of dollars except share and per share data, or unless otherwise noted.

## 25. EXPENSES BY NATURE

| | Year Ended December 31, 2011 | From Incorporation, February 10, 2010, to December 31, 2010 |
|---|---|---|
| Salaries, benefits and people costs | **195,569** | 146,223 |
| Depreciation and amortization | **32,666** | 23,646 |
| Food | **11,743** | 8,903 |
| Property taxes | **9,676** | 7,342 |
| Utilities | **8,504** | 5,576 |
| Other | **33,790** | 21,131 |
| **Total expenses** | **291,948** | 212,821 |

## 26. SEGMENTED INFORMATION

Segmented information is presented in respect of the Company's business segments. The primary format, business segments, is based on the Company's management and internal reporting structure. The Company operates solely within Canada, hence no geographical segment disclosures are presented. Inter-segment pricing is determined on an arm's length basis. Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

The Company is comprised of the following main business segments:

- LTC business – LTC is the core business of the Company and also reflects corporate office costs;
- PHCS – PHCS retains its own management team and compiles its own financial information. PHCS is an accredited provider of professional nursing, personal support and education services for both community-based home care and LTC homes; and
- Retirement Residences – includes the Kingston and Kanata retirement residences acquired by The Royale LP on April 27, 2011, as well as the Scarborough independent living and the Muskoka retirement residence.

The significant accounting policies of the reportable operating segments are the same as those disclosed in Note 3.

| | Year Ended December 31, 2011 | | | |
|---|---|---|---|---|
| | RR | PHCS | LTC | Total |
| Gross revenue | 6,964 | 13,192 | 298,739 | 318,895 |
| Less: Internal revenue | – | 2,306 | 26,482 | 28,788 |
| Net revenue | 6,964 | 10,886 | 272,257 | 290,107 |
| Income from operations before the undernoted | 2,045 | 2,247 | 27,217 | 31,509 |
| Depreciation/amortization | | | | |
| Property and equipment | 2,358 | 1 | 15,019 | 17,378 |
| Intangible assets | 1,061 | 1,037 | 13,190 | 15,288 |
| Finance costs | 1,903 | – | 17,035 | 18,938 |
| Finance income | – | – | (3,232) | (3,232) |
| Loss (gain) on interest rate swap contracts | 826 | – | (142) | 684 |
| Income tax recovery | – | – | (5,570) | (5,570) |
| Net income (loss) | (4,103) | 1,209 | (9,083) | (11,977) |
| Purchase of property and equipment | 160 | 8 | 830 | 998 |
| Purchase of intangible assets | – | – | 575 | 575 |

| | | | | As at December 31, 2011 |
|---|---|---|---|---|
| | RR | PHCS | LTC | Total |
| Total assets | **105,601** | **9,669** | **529,281** | **644,551** |
| Goodwill | **342** | **6,521** | **84,603** | **91,466** |
| Intangible assets | **3,715** | **1,281** | **81,377** | **86,373** |

| | From Incorporation, February 10, 2010, to December 31, 2010 | | | |
|---|---|---|---|---|
| | RR | PHCS | LTC | Total |
| Gross revenue | 878 | 9,003 | 226,059 | 235,940 |
| Less: Internal revenue | – | 1,694 | 20,638 | 22,332 |
| Net revenue | 878 | 7,309 | 205,421 | 213,608 |
| Income from operations before the undernoted | 394 | 1,469 | 22,372 | 24,235 |
| Depreciation/amortization | | | | |
| Property and equipment | 796 | 7 | 11,814 | 12,617 |
| Intangible assets | – | 803 | 10,226 | 11,029 |
| Finance costs | 233 | – | 13,244 | 13,477 |
| Finance income | – | – | (2,847) | (2,847) |
| Gain on interest rate swap contracts | (3) | – | (195) | (198) |
| Income tax recovery | – | – | (2,744) | (2,744) |
| Net income (loss) | (632) | 659 | (7,126) | (7,099) |
| Purchase of property and equipment | – | – | 945 | 945 |
| Purchase of intangible assets | – | – | 872 | 872 |

| | | | | As at December 31, 2010 |
|---|---|---|---|---|
| | RR | PHCS | LTC | Total |
| Total assets | 9,798 | 10,354 | 558,269 | 578,421 |
| Goodwill | 342 | 6,521 | 84,603 | 91,466 |
| Intangible assets | – | 2,318 | 93,991 | 96,309 |

## 27. CONTINGENCIES

The former majority owner of Leisureworld is involved in a lawsuit with a former supplier, Corporate Building Services Inc. (the "CBSI Claim"). The CBSI Claim is for $5,860. Markham Suites Hotel Limited ("MSHL"), formerly Leisureworld Inc., whose assets were acquired by LSCLP (October 18, 2005), was added as a defendant during 2006. The court awarded costs for an appeal made by CBSI, who opposed putting up security for the cost of the Company, as was previously ordered by the court. The appeal was dismissed with costs and the court confirmed that CBSI must put up $90, as security for the Company's costs before CBSI can proceed to a trial hearing. CBSI to date has not put up the money as ordered and thus the matter has not been pursued. The Company has the option of applying to court to dismiss the case, by virtue of CBSI failing to comply with the court's direction, the costs of which are estimated to be $20 to $25, which are unlikely to be recovered from CBSI. Doing this would most likely result in the action being dismissed with costs, but the prospect of recovering these costs is highly unlikely. In view of this, management has advised its counsel that it does not wish to incur these costs and to not pursue this action any further.

## 28. SUBSEQUENT EVENT

On January 12, 2012, the Company entered into an agreement to acquire the Madonna Long-Term Care Residence, a 160 bed, "A" Class home in Orleans, Ontario, a suburb of Ottawa.

The purchase transaction is for $20,100, comprised of $13,400 for the operating business and approximately $6,700 of construction funding. Incremental expenses for transaction and land transfer costs are expected to be approximately $1,100. This transaction is subject to approval by the MOHLTC and the Local Health Integration Network. The transaction is expected to close in 2012.

## BOARD OF DIRECTORS

### Dino Chiesa – Chairman & Director[1, 2]

Principal, Chiesa Group, commercial property investors
Chair of Board of Directors of Canada Mortgage and Housing Corporation
Former Trustee and Vice-Chair of Canadian Apartment Properties Real Estate Investment Trust (“CAP REIT”)
Former Board Member, Kingsway Arms Retirement Residences Inc.

### Janet Graham – Director[1, 2, 3]

Managing Director at IQ Alliance Incorporated
Board Member, Toronto Waterfront Revitalization Corporation
Former Trustee of Partners Real Estate Investment Trust (formerly, Charter Real Estate Investment Trust)
Former Trustee IPC US, Real Estate Investment
Former Board Member of Crystal River Capital, Inc.

### John McLaughlin – Director[1, 2, 4]

President of Tall Oak Management Inc.
Former Board Member of Futuremed Healthcare Products Corporation
Former Chair and Board Member of AIM Health Group
Past Managing Director of Extendicare (UK) Ltd., Past President of Extendicare (Canada) Inc., and Past President of Extendicare Health Services Inc.

### Jack MacDonald – Director[1, 2]

Current Chair and former CEO of Compass Group Canada and ESS North America
Past Chair of the Canadian Foundation for Dietetic Research
Past Board Member of the Canadian Physiotherapy Association

### David Cutler – Director

President and Chief Executive Officer of Leisureworld Senior Care Corporation
Director of Ontario Long Term Care Association (“OLTCA”)
Former Board Member of Futuremed Healthcare Products Corporation

[1] Member of Audit Committee
[2] Member of Compensation Committee
[3] Chair of Audit Committee
[4] Chair of Compensation Committee

## OFFICERS

### Chief Executive Officer

David Cutler

### Chief Financial Officer

Manny DiFilippo

### Chief Operating Officer

Paul Rushforth

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**STOCK LISTING**
Toronto Stock Exchange

**SHARE SYMBOL**
LW

**CORPORATE OFFICE**
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Suite 200
Markham, Ontario L3R 0E8

**LOCATIONS**

**Altamont**
92 Island Road
West Hill, Ontario M1C 2P5

**Barrie**
130 Owen Street
Barrie, Ontario L4M 3H7

**Brampton Meadows**
215 Sunny Meadow Boulevard
Brampton, Ontario L6R 3B5

**Brampton Woods**
9257 Goreway Drive
Brampton, Ontario L6P 0N5

**Brantford**
389 West Street
Brantford, Ontario N3R 3V9

**Cheltenham**
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**Creedan Valley**
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**Ellesmere**
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Scarborough, Ontario M1P 5G2

**Elmira**
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Elmira, Ontario N3B 2Y9

**Etobicoke**
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Etobicoke, Ontario M9W 7H3

**Lawrence**
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**Mississauga**
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Mississauga, Ontario L5B 1M8

**Muskoka and Muskoka Retirement**
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Gravenhurst, Ontario P1P 1P3

**Norfinch**
22 Norfinch Drive
North York, Ontario M3N 1X1

**North Bay**
401 William Street
North Bay, Ontario P1A 1X5

**O'Connor Court**
1800 O'Connor Drive
Toronto, Ontario M4A 1W7

**O'Connor Gate**
1800 O'Connor Drive
Toronto, Ontario M4A 1W7

**Oxford**
263 Wonham Street South
Ingersoll, Ontario N5C 3P6

**Richmond Hill**
170 Red Maple Road
Richmond Hill, Ontario L4B 4T8

**Rockcliffe**
3015 Lawrence Avenue East
Scarborough, Ontario M1P 2V7

**Scarborough and Midland Gardens**
130 Midland Avenue
Scarborough, Ontario M1N 4B2

**Spencer House**
835 West Ridge Boulevard
Orillia, Ontario L3V 8B3

**St. George**
225 St. George Street
Toronto, Ontario M5R 2M2

**Streetsville**
1742 Bristol Road West
Mississauga, Ontario L5M 1X9

**Tullamore**
133 Kennedy Road South
Brampton, Ontario L6W 3G3

**The Royale Kanata**
3501 Campeau Drive
Kanata, ON K2K 0C1

**The Royale Kingston**
2485 Princess Street
Kingston, ON K7M 3G1

**Vaughan**
5400 Steeles Avenue West
Woodbridge, Ontario L4L 9S1

**REGISTRAR AND TRANSFER AGENT**
Computershare Trust Company of Canada
100 University Avenue
9th Floor, North Tower
Toronto, Ontario, Canada
M5J 2Y1
Phone: 1-800-564-6253
(toll-free in Canada and the U.S.)
or 514-982-7555 (international direct call)

**ANNUAL MEETING**
The Annual Meeting for Shareholders will be held on:
Wednesday, April 18, 2012
Design Exchange
234 Bay Street
3rd Floor
Patty Watt Room
Toronto, ON

Time: 10:00 a.m.


## Our Caring Philosophy

Leisureworld's Caring Philosophy is a comprehensive commitment to quality of care and quality of life for residents

**EMBRACING LIFE STORIES**

Leisureworld recognizes the importance of embracing each resident as an individual with individual life stories and needs, and is firmly committed to building on our residents' pasts and experiences

**EMPOWERING VOICE AND CHOICE**

Leisureworld appreciates the human need for autonomy and is dedicated to encouraging and empowering residents and always advocating on their behalf

**ENGAGING BODY, MIND AND SPIRIT**

Leisureworld employs a holistic approach to wellness by focusing on recreational, spiritual and physical care, engaging residents' minds, bodies and spirit

**LEISUREWORLD SENIOR CARE CORPORATION**
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