



**NORTHSTAR HEALTHCARE**

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**NORTHSTAR HEALTHCARE INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**For the Three and Six Months Ended June 30, 2008**

*The following management discussion and analysis of the financial condition and results of operations of Northstar Healthcare Inc. (the "Company" or "NHC") for the three and six months ended June 30, 2008 is provided as of August 8, 2008. It is supplemental to, and should be read in conjunction with, the financial statements of the Company for the three and six months ended June 30, 2008. The Company's financial statements are prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). Substantially all of the Company's operating cash flows are in U.S. dollars; accordingly, all amounts presented herein are stated in thousands of U.S. dollars, except per share data, unless otherwise indicated.*

## **FORWARD LOOKING INFORMATION**

This management's discussion and analysis contains "forward-looking information" (as defined under applicable securities laws). Forward-looking information is typically identified by words such as "believe," "expect," "forecast," "anticipate," "intend," "estimate," "goal," "plan," and "project" and similar expressions of future or conditional verbs such as "will," "may," "should," "could," or "would". These statements reflect current beliefs and are based on information currently available to management.

By its very nature, forward-looking information involves significant known and unknown risks, uncertainties and assumptions. Important assumptions relating to the forward-looking information contained in this management's discussion and analysis include expansion, capital expenditures, competitive conditions and gross economic conditions.

Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking information, including, without limitation, general business risks inherent in the ASC industry, including changing surgeon and patient preferences, numerous federal, state and local laws, competition from other healthcare providers and our dependence on payment from third-party payors, including private insurers, managed care organizations and government healthcare programs. For a description of risks that could cause our actual results to materially differ from our current expectations, please see section titled "Risk Factors" in NHC's Annual Information Form, dated March 31, 2008. Although the forward-looking information contained in this MD&A is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. Should one or more of these risks or uncertainties materialize or should assumptions underlying the forward-looking statements prove incorrect, actual results, performance or achievements could vary materially from those expressed or implied by the forward-looking information. Certain statements regarding forward-looking information included in this MD&A may be considered "financial outlook" for purposes of applicable securities laws, and such financial outlook may not be appropriate for purposes other than this MD&A.

All forward-looking information in this MD&A is qualified by these cautionary statements. The forward-looking statements in this management's discussion and analysis are made as of the date hereof and except as required by law we do not intend, and do not assume any obligation, to update or revise these forward-looking statements.

## **NON-GAAP FINANCIAL MEASURES**

This management's discussion and analysis contains references to Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization, net of non-controlling interests and before unrealized gain on foreign currency exchange contracts and change in fair value of other liabilities, non-controlling interest) and Adjusted EBITDA Margin (adjusted EBITDA, net of capital expenditures divided by net patient service revenue). Management believes that Adjusted EBITDA is a useful supplemental measure of cash available for dividends prior to debt service, capital expenditures, income taxes and other reserves. However, Adjusted EBITDA is not a recognized measure under Canadian GAAP and does not have a standardized meaning prescribed by Canadian GAAP. Therefore, Adjusted EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that Adjusted EBITDA should not be construed as an alternative to net income or loss (which are determined in accordance with Canadian GAAP) as an indicator of the performance of the Company or its subsidiaries or as a measure of liquidity and cash flows.

## PRESENTATION OF FINANCIAL INFORMATION

The Company was incorporated on March 16, 2007 and completed its initial public offering and acquisition of its subsidiaries on May 17, 2007. At the time of the Company's initial public offering, it acquired controlling interests in two distinct businesses: The Palladium for Surgery – Houston, L.P. (the "Palladium Partnership") and Medical Ambulatory Surgical Suites, Ltd (the "Kirby Partnership" and together with the Palladium Partnership, the "Northstar Partnerships").

This management discussion and analysis includes the adjusted pro forma combined operating results of the Company for the period of January 1, 2007 to May 16, 2007 prior to the public offering. Certain figures disclosed in these adjusted pro forma combined operating results differ from the pro forma combined operating results previously disclosed in the Company's Business Acquisition Report, dated July 27, 2007, for the quarter ended June 30, 2007, as a result of management's change in estimates used to determine net patient service revenues made following the introduction of new reporting and trending software in the third quarter of 2007.

In addition, the adjusted pro forma combined operating results for the period of January 1, 2007 to May 16, 2007 are not necessarily indicative of the results that would have actually occurred had the transaction been consummated at the dates indicated nor are they necessarily indicative of future operating results or the financial position of the Company, as the adjusted pro forma combined operating results excludes expenses related to being a public issuer, as well as expenses of Northstar Healthcare Acquisitions, LLC, the Company's operating subsidiary.

We have also included a number of comparative operating statistics, such as cases and procedures performed at the facilities operated by the Palladium Partnership and the Kirby Partnership for the three and six month ended June 30, 2008 compared with the prior year periods. Cases and procedures are key drivers of our revenues. This information is not intended to provide a comprehensive comparison of financial results, as gross billings and net patient service revenues vary by patient, insurance carrier and procedure.

## CORPORATE OVERVIEW

NHC was incorporated under the *Business Corporations Act* (British Columbia) on March 16, 2007. NHC is a corporation formed to indirectly acquire and/or manage ambulatory surgery centres in the United States, focusing initially on Houston and other metropolitan areas in Texas. NHC used the net proceeds of an initial public offering, including the over-allotment, to indirectly acquire a 70% partnership interest in the Palladium Partnership and a 60% partnership interest in the Kirby Partnership, which operate two ambulatory surgery centres (the "Northstar ASCs") located in Houston. In addition, NHC manages an ambulatory surgery centre in Dallas and three pain management clinics in Houston.

The Northstar ASCs are licensed ambulatory surgery centres that provide scheduled surgical procedures in a limited number of clinical specialties, which enables them to develop routines, procedures and protocols to maximize operating efficiency and productivity while offering an enhanced healthcare experience for both surgeons and patients. The Northstar ASCs consist of The Palladium For Surgery - Houston and the Kirby Surgery Center.

Together, the Northstar ASCs have seven operating suites, three procedure or treatment rooms typically used by pain management specialists or for colonoscopies, 12 pre-operation beds, 17 post-operation or recovery beds and 124 surgeons with medical staff privileges.

The Northstar ASCs do not offer the full range of services typically found in traditional hospitals, but instead focus on certain clinical specialties, including orthopaedic surgery, podiatry surgery, ear, nose and throat ("ENT"), pain management, and general surgery.

**RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2008 AND THE  
ADJUSTED PRO FORMA COMBINED RESULTS OF OPERATIONS FOR THE THREE  
MONTHS ENDED JUNE 30, 2007**  
( in 000's of US \$, except per share data)  
(Unaudited)

	Three Months Ended June 30, 2008	Adjusted Pro forma Combined 46 Days Ended May 16, 2007	Actual 45 Days ended June 30, 2007	Adjusted Pro forma Combined Three Months Ended June 30, 2007
Net patient service revenue.....	\$ 10,926	\$ 6,186	\$ 6,818	\$ 13,004
<b>Operating expenses</b>				
Salaries and benefits.....	1,658	622	749	1,371
Drugs and supplies.....	939	560	503	1,063
General and administrative.....	1,905	593	592	1,185
Depreciation and amortization.....	447	207	202	409
	<u>4,949</u>	<u>1,982</u>	<u>2,046</u>	<u>4,028</u>
<b>Income from operations.....</b>	<b><u>5,977</u></b>	<b><u>4,204</u></b>	<b><u>4,772</u></b>	<b><u>8,976</u></b>
<b>Other expense (income)</b>				
Distribution, other liabilities, non-controlling interest.....	435	274	222	496
Withholding tax.....	345	192	167	359
(Gain) / loss on foreign currency.....	(1,600)	-	(2,344)	(2,344)
Change in fair value of other liabilities, non-controlling interest....	500	-	3,050	3,050
State franchise tax.....	69	-	49	49
Other expense (income).....	(18)	6	(9)	(3)
	<u>(269)</u>	<u>472</u>	<u>1,135</u>	<u>1,607</u>
<b>Income before income taxes and non-controlling interest .....</b>	<b><u>6,246</u></b>	<b><u>3,732</u></b>	<b><u>3,637</u></b>	<b><u>7,369</u></b>
<b>Income tax expense</b>				
Current.....	(171)	110	133	243
Future.....	1,291	415	410	825
	<u>1,120</u>	<u>525</u>	<u>543</u>	<u>1,068</u>
<b>Non-controlling interests.....</b>	<b><u>2,236</u></b>	<b><u>1,153</u></b>	<b><u>1,725</u></b>	<b><u>2,878</u></b>
<b>Net income and comprehensive income.....</b>	<b><u>\$ 2,890</u></b>	<b><u>\$ 2,054</u></b>	<b><u>\$ 1,369</u></b>	<b><u>\$ 3,423</u></b>
<b>Net income per common share (basic and fully diluted).....</b>	<b><u>\$ 0.21</u></b>	<b><u>\$ 0.16</u></b>	<b><u>\$ 0.10</u></b>	<b><u>\$ 0.26</u></b>
<b>Weighted average number of shares outstanding (basic and fully diluted).....</b>	<b><u>13,900,852</u></b>	<b><u>13,117,899</u></b>	<b><u>13,117,899</u></b>	<b><u>13,117,899</u></b>

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Revenue is recognized upon the performance of the patient service. The amounts actually collected by the Company from third-party payors, including private insurers, are variable, even for identical procedures. An additional factor in the determination of net patient service revenues is the Company's payor mix, as between private health insurance plans, workers' compensation, directly from patients and from government payor plans. Management reviews and evaluates historical payment data, payor mix and current economic conditions on a periodic basis and adjusts the estimated collections as a percentage of gross billings (which are used to determine net patient service revenue) as required in subsequent periods based on final settlements and collections.

As disclosed in Company's Management Discussion and Analysis for the third quarter of 2007, a \$0.8 million adjustment in reduction was made to net patient service revenues for the forty-five day period ending June 30, 2007. The following analysis includes result from both before and after taking the adjustment.

Net patient service revenues for the three months ended June 30, 2008 totalled \$10.9 million, a decrease of \$2.1 million or 16.0% compared to \$13.0 million for the adjusted pro forma combined three months ended June 30, 2007, before including the adjustment for the forty-five day period ending June 30, 2007. With the adjustment, net patient service revenues for the three months ended June 30, 2008 was decreased by \$1.3 million or 10.5% from \$12.2 million for the adjusted pro forma combined three months ended June 30, 2007. While the total number of cases performed at the Northstar ASCs increased by 115 cases during the three months ended June 30, 2008 as compared to the prior year period, the decrease in net patient service revenues was due to a negative shift in payor mix.

Salaries and benefits for the three months ended June 30, 2008 totalled \$1.7 million, which exceeded the salaries and benefits for the adjusted pro forma three months ended June 30, 2007 by \$0.3 million or 21%. The increase was due to the inclusion of salaries and benefits for employees of Northstar Acquisitions, the Company's operating subsidiary; as such expense was only partially included in the 45-days ended June 30, 2007. Salaries and benefits expense for Northstar Acquisitions was \$0.3 million for the three months ended June 30, 2008.

Drugs and medical supplies for the three months ended June 30, 2008 decreased by \$0.2 million or 11.8% to \$0.9 million from \$1.1 million for the adjusted pro forma combined three months ended June 30, 2007. As a percentage of net patient service revenues, prior to the \$0.8 million revenue adjustment for the forty-five day period ending June 30, 2007, drugs and medical supplies increased by 0.4% from 8.2% for the adjusted pro forma three months combined ended June 30, 2007 to 8.6% for the three months ended June 30, 2008. With the adjustment, drugs and medical supplies decreased by 0.1% from 8.7% for the adjusted pro forma three months combined ended June 30, 2007 to 8.6% for the three months ended June 30, 2008. The decrease of \$0.2 million or 0.1% of net patient service revenues inclusive of adjustment was due to an overall decrease of 537 procedures for the Northstar Partnerships and a decrease in net patient service revenues due to payor mix at the Kirby Partnership.

General and administrative expense for the three months ended June 30, 2008 totalled \$1.9 million, which exceeded the general and administrative expense for the adjusted pro forma three months ended June 30, 2007 by \$0.7 million, or 60.6%. As a percentage of net patient service revenues, prior to the \$0.8 million revenue adjustment for the forty-five day period ending June 30, 2007, general and administrative expense increased by 8.3% from 9.1% for the adjusted pro forma three months combined ended June 30, 2007 to 17.4% for the three months ended June 30, 2008. With the adjustment, general and administrative expense increased by 7.7% from 9.7% for the adjusted pro forma three months combined ended June 30, 2007 to 17.4% for the three months ended June 30, 2008. The increase was primarily due to general and administrative expenses incurred by Northstar Acquisitions as such general and administrative expense were only partially included in the adjusted pro forma combined results for the three months ended June 30, 2007. The majority of these general and administrative expenses, including legal, accounting, insurance and directors' and officers' compensation, relate to expenses associated with being a reporting issuer in Canada. In addition, the Company incurred additional costs related to recruitment of the Northstar Acquisition's first Chief Operating Officer, as well as the additional costs related to common area maintenance expense.

Distributions, other liabilities, and non-controlling interest totalled \$0.4 million, withholding tax totalled \$0.3 million, gain on foreign currency exchange contracts totalled \$1.6 million and change in fair value of other liabilities, non-controlling interest totalled \$0.5 million. Non-controlling interests amounted to \$2.2 million based on percentage of minority interests owned by the physician limited partners and Healthcare Ventures Ltd. ("Ventures").

The gain on foreign currency exchange contracts of \$1.6 million relates to the change during the period in fair value of the five-year foreign currency exchange contracts entered into by the Company to hedge exposure to fluctuations between the U.S. dollar and the Canadian dollar for future Common Share dividends. This gain was as a result of the decline in value of the U.S. dollar during the period, net of realized gains recognized between the spot rate on the date of record and the exchange rate under the Company's currency instruments.

The \$0.5 million change in the fair value of other liabilities, non-controlling interest represents the change in fair value of the Class B Units of Northstar Healthcare Subco, L.L.C. ("Northstar Subco") held by Ventures, which fair value was based on an external appraisal incorporating the discounted cash flow method as at June 30, 2008. This item is recorded as an income or expense of the Company under Canadian GAAP as a result of the negotiation right held by Ventures, which entitles it to request at any time after May 17, 2010 that Northstar Subco enter into good faith negotiations to purchase for cancellation all or any portion of the Class B Units of Northstar Subco held by Ventures. The price paid for such Northstar Subco Class B Units will be equal to their fair market value plus the fair market value of a corresponding number of Class B Units of Northstar Acquisitions. Northstar Acquisitions will purchase for cancellation all outstanding Class B Units of Northstar Acquisitions for a nominal amount on the date that all outstanding Class B Units of Northstar Subco have been purchased for cancellation from Ventures by Northstar Subco.

**NET PATIENT SERVICE REVENUES BY PAYOR MIX OF THE NORTHSTAR ASCS FOR THE THREE MONTHS ENDED JUNE 30, 2008 AND 2007**

<b>Financial Class</b>	<b>Q2 2008 Net Patient Service Revenue by Payor Mix</b>	<b>Q2 2007 Net Patient Service Revenue by Payor Mix</b>
Private insurance and other private pay..	91.6%	91.0%
Workers compensation.....	4.9%	5.3%
Medicare/Medicaid.....	1.3%	1.4%
Other.....	2.3%	2.3%
<b>Total.....</b>	<b>100.0%</b>	<b>100.0%</b>

Net patient service revenues represent gross revenues received from patients and third-party payors, less provisions for contractual adjustments with third-party payors, such as Medicare, Medicaid or private payors with managed care plans. This information is not intended to provide a comprehensive comparison of financial results, as reimbursement by insurance carrier varies based on deductibles, plan coverage and procedures performed.

Reimbursement is the highest from patients with private insurance and other private pay and lowest from patients with Medicare/Medicaid.

**CASE AND PROCEDURE MIX OF THE NORTHSTAR ASCS FOR THE THREE MONTHS ENDED JUNE 30, 2008 AND 2007**

<b>Specialty</b>	<b>Q2 2008 Cases</b>	<b>Q2 2008 Percentage of Cases</b>	<b>Q2 2008 Procedures</b>	<b>Q2 2008 Percentage of Procedures</b>	<b>Q2 2007 Cases</b>	<b>Q2 2007 Percentage of Cases</b>	<b>Q2 2007 Procedures</b>	<b>Q2 2007 Percentage of Procedures</b>
Pain Management.....	1,302	52.0%	7,482	68.4%	1,299	54.4%	7,836	68.3%
Orthopaedics.....	580	23.2%	1,447	13.2%	526	22.0%	1,465	12.8%
Podiatry.....	159	6.3%	623	5.7%	166	6.9%	592	5.2%
Gastro-intestinal.....	182	7.3%	276	2.5%	140	5.9%	244	2.1%
General Surgery.....	121	4.8%	263	2.4%	96	4.0%	339	3.0%
ENT.....	160	6.4%	851	7.8%	162	6.8%	1,003	8.7%
<b>Total.....</b>	<b>2,504</b>	<b>100.0%</b>	<b>10,942</b>	<b>100.0%</b>	<b>2,389</b>	<b>100.0%</b>	<b>11,479</b>	<b>100.0%</b>

**Note:** A procedure is defined as the actual surgery or surgeries that are performed on the date of service for each patient (case). Each case typically includes numerous procedures. In prior management discussion and analysis reports, the Company provided the number of “unique” procedures per case as the total number of procedures during the period (i.e. a patient may have three different procedures performed, however, one of the three procedures might have been performed numerous times during the case). In this management discussion and analysis, the Company has calculated the total quantity of procedures performed on a case, regardless of the fact that the same procedure may have been performed numerous times. As a result, the total number of procedures has been adjusted in the 2007 period. This change in the number of procedures has no effect on the number of cases or net patient service revenues, and was adjusted to provide the total number of all procedures for analysis purposes only.

We have provided a number of comparative operating statistics, such as cases and procedures performed at the facilities operated by the Palladium Partnership and the Kirby Partnership for the three-month period ended June 30, 2008 compared with the same period in the prior year. Cases and procedures are two of the key drivers of our revenues. This information is not intended to provide a comprehensive comparison of financial results, as gross billings and net patient service revenues vary by patient, insurance carrier and procedure.

A case is defined as a patient visit to the ambulatory surgery center on a specific date of service. A procedure is defined as the actual surgery or surgeries that are performed on the date of service. As a result, there may be more than a single procedure performed during a specific case.

Total cases for the three months ended June 30, 2008 were 2,504, an increase of 115 cases over the 2,389 total cases in the same period in 2007. Total procedures for the three months ended June 30, 2008 were 10,942, a decrease of 537 procedures from 11,479 in the same period in 2007.

Cases and procedures for the three months ended June 30, 2008 fluctuated between specialties as a result of physician vacations and continuing education schedule as well as changes in coding practice based on recommendations from annual coding audits. Case increases in orthopaedics, gastro-intestinal, and general surgery specialties were offset by slight decreases in podiatry and ear, nose and throat (ENT) specialties. During the three months ended June 30, 2008, the Company conducted a quality improvement review of its billing and coding practice. Due to efficiencies identified, the number of procedures per case decreased in certain pain management, orthopaedics, and ENT cases, compared to the three months ended June 30, 2007. Since case reimbursement is based on case type, the decrease in the number of procedures per case has no effect on reimbursement and net patient service revenues per case.

**RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA FOR THE THREE MONTHS ENDED JUNE 30, 2008 TO THE ADJUSTED PRO FORMA COMBINED RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2007**  
(in 000's of US \$, except per share data)  
(Unaudited)

	Three Months Ended June 30, 2008	Adjusted Pro forma Combined 46 Days Ended May16, 2007	Actual 45 Days ended June 30, 2007	Adjusted Pro forma Combined Three Months Ended June 30, 2007
Net patient service revenue.....	\$ 10,926	\$ 6,186	\$ 6,818	\$ 13,004
Net income and comprehensive income.....	\$ 2,890	\$ 2,053	\$ 1,369	\$ 3,422
Add:				
Depreciation and amortization.....	447	207	202	409
(Gain)/ loss on foreign currency exchange contracts.....	(1,600)	-	(2,344)	(2,344)
Change in fair value of other liabilities, non-controlling interest.....	500	-	3,050	3,050
Income tax (current&future).....	1,120	525	543	1,068
<b>Adjusted EBITDA</b> .....	<b>3,357</b>	<b>2,785</b>	<b>2,820</b>	<b>5,605</b>
Less:				
Capital expenditures.....	(161)	(3)	(59)	(62)
<b>Adjusted EBITDA net of capital expenditures</b> .....	<b>\$ 3,196</b>	<b>\$ 2,782</b>	<b>\$ 2,761</b>	<b>\$ 5,543</b>
<b>Adjusted EBITDA margin net of capital expenditures</b> .....	29.3%	45.0%	40.5%	42.6%

- (1) Cash available to the Company to pay dividends for the three months ended June 30, 2008 is \$0.2 million more than Adjusted EBITDA net of non-controlling interest and capital expenditures, and before unrealized gain on foreign currency exchange contracts and change in fair value of other liabilities, non-controlling interest, on account of current taxes.
- (2) Cash available to the Company to pay dividends for the three months ended June 30, 2007 is \$0.2 million less than Adjusted EBITDA net of non-controlling interest and capital expenditures, and before unrealized gain on foreign currency exchange contracts and change in fair value of other liabilities, non-controlling interest, on account of current taxes.

Adjusted EBITDA before non-controlling interests of the Physician Limited Partners and distributions to Ventures for the three months ended June 30, 2008 was \$3.4 million. The Company currently has a policy of distributing its available cash from consolidated operations, subject to applicable laws, by way of a monthly dividend on its Common Shares, after the retention of amounts considered reasonable and prudent by the Board of Directors for

working capital and other purposes, including capital investment and capital reserves. Cash dividends declared for the three months ended June 30, 2008 totalled \$4.2 million or \$0.299 (Cdn \$0.30) per Common Share.

**RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2008 TO THE  
ADJUSTED PRO FORMA COMBINED RESULTS OF OPERATIONS FOR THE SIX MONTHS  
ENDED JUNE 30, 2007**  
(in 000's of US \$, except per share data)  
(Unaudited)

	Six Months Ended June 30, 2008	Adjusted Pro forma Combined January 1, 2007 to May 16, 2007	Actual 45 Days ended June 30, 2007	Adjusted Pro forma Combined Six Months Ended June 30, 2007
Net patient service revenue.....	\$ 21,879	\$ 17,306	\$ 6,818	\$ 24,124
<b>Operating expenses</b>				
Salaries and benefits.....	3,195	1,945	749	2,694
Drugs and supplies.....	1,811	1,378	503	1,881
General and administrative.....	3,710	1,753	592	2,345
Depreciation and amortization.....	886	611	202	813
	<u>9,602</u>	<u>5,687</u>	<u>2,046</u>	<u>7,733</u>
<b>Income from operations</b>	<u>12,277</u>	<u>11,619</u>	<u>4,772</u>	<u>16,391</u>
<b>Other expense (income)</b>				
Distribution, other liabilities, non-controlling interest.....	862	821	222	1,043
Withholding tax.....	691	575	167	742
(Gain) / loss on foreign currency.....	1,245	-	(2,344)	(2,344)
Change in fair value of other liabilities, non-controlling interest	(800)	-	3,050	3,050
State franchise tax.....	143	-	49	49
Other expense (income).....	(48)	19	(9)	10
	<u>2,093</u>	<u>1,415</u>	<u>1,135</u>	<u>2,550</u>
<b>Income before income taxes and non-controlling interest.....</b>	<u>10,184</u>	<u>10,204</u>	<u>3,637</u>	<u>13,841</u>

	Six Months Ended June 30, 2008	Adjusted Pro forma Combined January 1, 2007 to May 16, 2007	Actual 45 Days ended June 30, 2007	Adjusted Pro forma Combined 6 Months Ended June 30, 2007
<b>Income tax expense</b>				
Current.....	(329)	(60)	133	73
Future.....	983	1,245	410	1,655
	<u>654</u>	<u>1,185</u>	<u>543</u>	<u>1,728</u>
<b>Non-controlling interests.....</b>	<u>4,538</u>	<u>3,420</u>	<u>1,725</u>	<u>5,145</u>
<b>Net income and comprehensive income.....</b>	<u>\$ 4,992</u>	<u>\$ 5,599</u>	<u>\$ 1,369</u>	<u>\$ 6,968</u>
<b>Net income per common share (basic and fully diluted).....</b>	<u>\$ 0.36</u>	<u>\$ 0.43</u>	<u>\$ 0.10</u>	<u>\$ 0.53</u>
<b>Weighted average number of shares outstanding (basic and fully diluted).....</b>	<u>13,900,852</u>	<u>13,117,899</u>	<u>13,117,899</u>	<u>13,117,899</u>

Net patient service revenues for the six months ended June 30, 2008 totalled \$21.9 million, a decrease of \$2.2 million or 9.3% compared to \$24.1 million for the adjusted pro forma combined six months ended June 30, 2007, before including the \$0.8 million adjustment for the forty-five day period ending June 30, 2007. With the adjustment, net patient service revenues for the six months ended June 30, 2008 was decreased by \$1.5 million or 6.4% from \$23.4 million for adjusted pro forma combined six months ended June 30, 2007. While the total number of cases performed at the Northstar ASCs increased by 109 cases during the six months ended June 30, 2008 as compared to the prior year period, the decrease in net patient service revenues was due to a negative shift in payor mix at the Kirby Partnership, which was partially offset by an increase of 1.5% in net patient service revenues at the Palladium Partnership.

Salaries and benefits for the six months ended June 30, 2008 totalled \$3.2 million, which exceeded the salaries and benefits for the adjusted pro forma six months ended June 30, 2007 by \$0.5 million or 18.6%. The increase was due to the inclusion of salaries and benefits for employees of Northstar Acquisitions, the Company's operating subsidiary (as such salaries and benefits were not included in the pro forma combined results for the three months ended June 30, 2007), which expense was \$0.6 million for the six months ended June 30, 2008.

Drugs and medical supplies for the six months ended June 30, 2008 decreased by \$0.1 million or 3.8% to \$1.8 million from \$1.9 million for the adjusted pro forma combined six months ended June 30, 2007. As a percentage of net patient service revenues, prior to the \$0.8 million revenue adjustment for the forty-five day period ending June 30, 2007, drugs and medical supplies increased by 0.5% from 7.8% for the adjusted pro forma six months combined ended June 30, 2007 to 8.3% for the six months ended June 30, 2008. With the adjustment, drugs and medical supplies increased by 0.2% from 8.1% for the adjusted pro forma six months combined ended June 30, 2007 to 8.3% for the six months ended June 30, 2008. The decrease of \$0.1 million or increase of 0.2% of net patient service revenues inclusive of adjustment was due to an overall decrease of 109 procedures for the Northstar Partnerships and a decrease in net patient service revenues due to payor mix at the Kirby Partnership.

General and administrative expense for the six months ended June 30, 2008 totalled \$3.7 million, which exceeded the general and administrative expense for the adjusted pro forma six months ended June 30, 2007 by \$1.4 million, or 58.2%. As percentage of net patient service revenues, prior to the \$0.8 million revenue adjustment for the forty-five day period ending June 30, general and administrative expense increased by 7.3% to 17.0% for the six months ended June 30, 2008 from 9.7% for the adjusted pro forma combined six months ended June 30, 2007. With the adjustment, general and administrative expense increased by 7.0% from 10.0% for the adjusted pro forma six months combined ended June 30, 2007 to 17.0% for the six months ended June 30, 2008. The increase was primarily due to general and administrative expenses incurred by Northstar Acquisitions as such general and administrative expense was partially included in the adjusted pro forma combined results for the six months ended June 30, 2007. The majority of these general and administrative expenses, including legal, accounting, insurance and directors' and officers' compensation, relate to expenses associated with being a reporting issuer in Canada.

In addition, the company incurred additional costs related to recruitment of the Company's first Chief Operating Officer and two new members of the Board of Directors as well as additional common area maintenance expense.

Distributions, other liabilities, and non-controlling interest totalled \$0.9 million, withholding tax totalled \$0.7 million, loss on foreign currency exchange contracts totalled \$1.2 million and change in fair value of other liabilities non-controlling interest totalled \$0.8 million. Non-controlling interests amounted to \$4.5 million based on percentage of minority interests owned by the physician limited partners and Ventures.

The loss on foreign currency exchange contracts of \$1.2 million relates to the change during the period in fair value of the five-year foreign currency exchange contracts entered into by the Company to hedge exposure to fluctuations between the U.S. dollar and the Canadian dollar for future Common Share dividends. This loss was as a result of the decline in value of the Canadian dollar during the period, net of realized gains recognized between the spot rate on the date of record and the exchange rate under the Company's currency instruments.

The \$0.9 million change in the fair value of other liabilities, non-controlling interest represents the change in fair value of the Class B Units of Northstar Subco held by Ventures, which fair value was based on an external appraisal incorporating the discounted cash flow method as at June 30, 2008. This item is recorded as an income or expense of the Company under Canadian GAAP as a result of the negotiation right held by Ventures, which entitles it to request at any time after May 17, 2010 that Northstar Subco enter into good faith negotiations to purchase for cancellation of all or any portion of the Class B Units of Northstar Subco held by Ventures. The price paid for such Northstar Subco Class B Units will be equal to their fair market value plus the fair market value of a corresponding number of Class B Units of Northstar Acquisitions. Northstar Acquisitions will purchase for cancellation of all outstanding Class B Units of Northstar Acquisitions for a nominal amount on the date that all outstanding Class B Units of Northstar Subco have been purchased for cancellation from Ventures by Northstar Subco.

#### **NET PATIENT SERVICE REVENUES BY PAYOR MIX OF THE NORTHSTAR ASCS FOR THE SIX MONTHS ENDED JUNE 30, 2008 AND 2007**

<b>Financial Class</b>	<b>2008 Net Patient Service Revenue by Payor Mix YTD</b>	<b>2007 Net Patient Service Revenue by Payor Mix YTD</b>
Private insurance and other private pay. ....	91.4%	90.6%
Workers compensation.....	5.0%	5.9%
Medicare/Medicaid.....	1.4%	1.2%
Other.....	2.3%	2.2%
<b>Total.....</b>	<b>100.0%</b>	<b>100.0%</b>

Net patient service revenues represent gross revenues received from patients less provisions for contractual adjustments with third-party payors, such as Medicare, Medicaid or private payors with managed care plans. This information is not intended to provide a comprehensive comparison of financial results, as reimbursement by insurance carrier varies based on deductibles, plan coverage and procedures performed. Reimbursement is the highest from patients with private insurance and other private pay and lowest from patients with Medicare/Medicaid.

**CASE AND PROCEDURE MIX OF THE NORTHSTAR ASCS FOR THE SIX MONTHS ENDED JUNE 30, 2008 AND 2007**

Specialty	2008		2008		2007		2007	
	Cases YTD	Percentage of Cases YTD	Procedures YTD	Percentage of Procedures YTD	Cases YTD	Percentage of Cases YTD	Procedures YTD	Percentage of Procedures YTD
Pain Management.....	2,586	53.9%	15,254	69.7%	2,509	53.5%	15,364	68.9%
Orthopaedics.....	1,096	22.9%	2802	12.8%	1,053	22.5%	2847	12.8%
Podiatry.....	280	5.8%	1119	5.1%	317	6.8%	1105	5.0%
Gastro-intestinal.....	312	6.5%	476	2.2%	291	6.2%	468	2.1%
General Surgery.....	200	4.2%	474	2.2%	188	4.0%	604	2.7%
ENT.....	321	6.7%	1755	8.0%	328	7.0%	1895	8.5%
<b>Total.....</b>	<b>4,795</b>	<b>100.0%</b>	<b>21,880</b>	<b>100.0%</b>	<b>4,686</b>	<b>100.0%</b>	<b>22,283</b>	<b>100.0%</b>

**Note:** A procedure is defined as the actual surgery or surgeries that are performed on the date of service for each patient (case). Each case typically includes numerous procedures. In prior management discussion and analysis reports, the Company provided the number of “unique” procedures per case as the total number of procedures during the period (i.e. a patient may have three different procedures performed, however, one of the three procedures might have been performed numerous times during the case). In this management discussion and analysis, the Company has calculated the total quantity of procedures performed on a case, regardless of the fact that the same procedure may have been performed numerous times. As a result, the total number of procedures has been adjusted in the 2007 period. This change in the number of procedures has no effect on the number of cases or net patient service revenues, and was adjusted to provide the total number of all procedures for analysis purposes only.

Cases and procedures for the six months ended June 30, 2008 fluctuated between specialties as a result of physician vacations and continuing education schedule as well as case complexity and changes in coding practice based on recommendations from annual coding audits. Case increases in pain management, orthopaedics, gastro-intestinal, and general surgery specialties were offset by slight decreases in podiatry and ear, nose and throat (ENT) specialties. During the three months ended June 30, 2008, the Company conducted a quality improvement review of its billing and coding practice. Due to efficiencies identified, the number of procedures per case decreased in certain pain management, orthopaedics, and ENT cases, compared to the six months ended June 30, 2007. Since case reimbursement is based on case type, the decrease in the number of procedures per case has no effect on reimbursement and net patient service revenues per case.

**RECONCILIATION OF NET INCOME TO ADJUSTED EBITDA FOR THE SIX MONTHS ENDED JUNE 30, 2008 TO THE ADJUSTED PRO FORMA COMBINED RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2007**  
(in 000's of US \$, except per share data)  
(Unaudited)

	Six Months Ended June 30, 2008	Adjusted Pro forma Combined January 1, 2007 to May 16, 2007	Actual 45 Days ended June 30, 2007	Adjusted Pro forma Combined Six Months Ended June 30, 2007
Net patient service revenue.....	\$ 21,879	\$ 17,306	\$ 6,818	\$ 24,124
Net income and comprehensive income.....	\$ 4,992	\$ 5,599	\$ 1,369	\$ 6,968
Add:				
Depreciation and amortization.....	886	611	202	813
(Gain)/ loss on foreign currency exchange contracts.....	1,245	-	(2,344)	(2,344)
Change in fair value of other liabilities, non-controlling interest.....	(800)	-	3,050	3,050
Income tax (current&future).....	654	1,185	543	1,728
<b>Adjusted EBITDA .....</b>	<b>6,978</b>	<b>7,395</b>	<b>2,820</b>	<b>10,215</b>

	<b>Six Months Ended June 30, 2008</b>	<b>Adjusted Pro forma Combined January 1, 2007 to May 16, 2007</b>	<b>Actual 45 Days ended June 30, 2007</b>	<b>Adjusted Pro forma Combined Six Months Ended June 30, 2007</b>
Less:				
Capital expenditures.....	(241)	(92)	(59)	(151)
<b>Adjusted EBITDA net of capital expenditures.....</b>	<b>\$ 6.737</b>	<b>\$ 7.303</b>	<b>\$ 2.761</b>	<b>\$ 10.064</b>
<b>Adjusted EBITDA margin net of capital expenditures.....</b>	30.8%	42.2%	40.5%	41.7%

- (1) Cash available to the Company to pay dividends for the six months ended June 30, 2008 is \$0.3 million more than Adjusted EBITDA net of non-controlling interest and capital expenditures, and before unrealized gain on foreign currency exchange contracts and change in fair value of other liabilities, non-controlling interest, on account of current taxes.
- (2) Cash available to the Company to pay dividends for the six months ended June 30, 2007 is \$0.1 less than Adjusted EBITDA net of non-controlling interest and capital expenditures, and before unrealized gain on foreign currency exchange contracts and change in fair value of other liabilities, non-controlling interest, on account of current taxes.

Adjusted EBITDA before non-controlling interests of the Physician Limited Partners and distributions to Ventures for the six months ended June 30, 2008 was \$7.0 million. Cash dividends declared for the six months ended June 30, 2008 totalled \$8.4 million or \$0.598 (Cdn \$0.60) per Common Share.

## LIQUIDITY, CAPITAL RESOURCES AND FINANCIAL CONDITION

Liquidity refers to an entity's ability to meet its financial obligations and commitments as they become due. Management anticipates that cash flows from operations and funds provided from time to time under available credit facilities will provide the Company with sufficient liquidity to manage accounts receivable, medical supplies and other short-term cash requirements for the next 12 months. Management expects to have sufficient working capital to meet the Company's obligations in 2008.

The Company is dependent upon cash generated from operating activities of the Northstar Partnerships, which are the source of financing for its operations and for meeting its contractual obligations. A majority of the Northstar Partnerships' cash flows is distributed, on a monthly basis, to the Company and holders of minority partnership interests.

The Company currently has a policy of distributing its available cash from consolidated operations, subject to applicable law and the terms of any then existing indebtedness, by way of monthly dividends on the Common Shares, after the retention of amounts considered reasonable and prudent by the Board of Directors for working capital and other purposes, including capital investment and capital reserves. Included in the calculation of the Company's cash available to pay dividends is a cash reserve equal to 10% of the Company's aggregate monthly dividend, which is retained by the Company, through its subsidiary, Northstar Subco. In addition, any cash in excess of the cash reserve and the amount necessary to pay the monthly dividend is also retained by the Company. The calculation of the monthly 10% cash reserve was \$1.7 million for the period of May 17, 2007 to June 30, 2008. As of June 30, 2008, the Company had cash reserves of \$1.9 million. Had the Company not deferred a portion of the Subco monthly distributions to Ventures of \$1.2 million for the period of May 17, 2007 to June 30, 2008, such cash reserves balances would have been \$0.7 million. Of the \$1.2 million deferral, \$0.3 million and \$0.7 million were for the three and six months ended June 30, 2008, respectively.

The Company determines the amount of its monthly dividend based on periodic reviews of its estimated annual earning and related estimated annual cash flows.

The Company's cash flow will vary from quarter to quarter based on seasonality of the operations. Based on historical trends, net patient service revenues for the third and fourth calendar quarters typically exceed the first and second calendar quarters by 4.0% to 5.0% in aggregate.

The Company's cash flow from operations was \$6.6 million and \$13.1 million for the three and six months ended June 30, 2008, respectively. Dividends paid and distributions to non-controlling interests were \$6.9 million and \$13.7 million for the three and six months ended June 30, 2008, respectively. Capital expenditures were \$0.2 million and \$0.2 million for the three and six months ended June 30, 2008, respectively.

Cash dividends declared in the three months ended June 30, 2008 totalled \$4.2 million or \$0.299 (Cdn \$0.30) per common share. Cash dividends declared in the six months ended June 30, 2008 total \$8.4 million or \$0.598 (Cdn \$0.60) per common share.

	<u>2nd Q 2008</u>	<u>1st Q 2008</u>	<u>4th Q 2007</u>	<u>3rd Q 2007</u>	<b>Period from May 17, 2007 to 2nd Q 2007</b>
Net patient service revenues.....	\$ 10,926	\$ 10,953	\$ 13,593	\$ 12,508	\$ 6,818
Net income.....	\$ 2,890	\$ 2,102	\$ 1,470	\$ 323	\$ 1,369
Net income per share.....	\$ 0.21	\$ 0.15	\$ 0.11	\$ 0.02	\$ 0.10

## CONTRACTUAL OBLIGATIONS

The Company leases property and certain equipment under non-cancellable operating lease arrangements which expire at various dates through 2014. Certain leases of real property provide options to extend the lease terms.

The following table outlines the future minimum payments under operating leases:

<u>Year</u>	<u>Amount</u>
2008 (remaining six months) .....	417
2009 .....	854
2010 .....	867
2011 .....	882
2012 .....	880
Thereafter.....	751
Total.....	<u>\$ 4,651</u>

## FINANCIAL INSTRUMENTS

### Foreign Exchange Contracts

The Company entered into foreign currency exchange contracts to manage the Company's exposure to fluctuations in the exchange rate between U.S. and Canadian currencies, which arise from the payment of dividends on its Common Shares.

As of June 30, 2008, the Company is committed to deliver approximately \$1.3 million monthly in exchange for approximately C\$1.4 million for the contract period of July 2008 to June 2012; \$1.4 million monthly in exchange for approximately C\$1.4 million for the contract period of July 2012 to June 2013 at stipulated exchange rates as follows:

<u>Contract Dates</u>	<u>US\$ to be delivered (in 000's)</u>	<u>Cdn\$ to be received (in 000's)</u>	<u>Cdn\$ per US\$</u>
July 2008 – June 2012	61,282	66,724	1.0888
July 2012 – December 2012	8,476	8,341	0.9840
January 2013 – June 2013	8,338	8,341	1.0003

The fair value of the Company's foreign currency contracts was \$3.5 million at June 30, 2008. Changes in the fair value during each reporting period are recorded as loss or gain on foreign currency in the consolidated statement of operations.

Ventures has provided collateral in the amount of \$5.0 million to secure performance under these contracts.

At the date of record, the Company records a liability based on the amount of U.S. funds required to pay the declared distribution using the Canadian to U.S. dollar foreign exchange spot rate then in effect. When the dividend is paid, the difference between the Canadian to U.S. dollar foreign exchange spot rate and the exchange rate under the Company's currency instruments is recognized as loss or gain on foreign currency. The gain recognized was \$0.3 million and \$0.7 million for the three and six months ended June 30, 2008, respectively.

## RELATED PARTY TRANSACTIONS

Physicians who represent the non-controlling interests in the Northstar Partnerships routinely provide independent professional services directly to patients utilizing the Northstar ASCs. In addition, Donald Kramer, M.D., NHC's Chief Executive Officer owns approximately 18.0% of the Palladium Partnership.

Donald Kramer, M.D., is the sole limited partner of Ventures. Ventures holds all of the Acquisitions Class B Units. Each Acquisitions Class B Unit entitles Ventures to receive monthly distributions of cash from Northstar Acquisitions equal to a specified percentage of Northstar Acquisitions' gross management fee revenues (including management fees earned for services earned under the Management and Cost Sharing Agreement between Northstar Acquisitions and the Northstar Partnerships and for services provided to other clients of Northstar Acquisitions), payable after all distributions have been made to the holders of Acquisitions Preferred Units and Acquisitions Class A Units. The specified percentage is currently equal to 12.5% and will decrease if Ventures disposes of Acquisitions Class B Units pursuant to its negotiation right.

Ventures also holds all of the Subco Class B Units. Each Subco Class B Unit entitles Ventures to receive monthly distributions of cash from Northstar Subco on a *pari passu* basis with the holders of the Subco Class A Units, except if the Company's cash available to pay dividends for any month is less than 110% of the initial full monthly dividend, Ventures' distribution from Northstar Subco shall be deferred by the amount of any shortfall.

Ventures, as promoter, received \$15.8 million in net proceeds from the initial public offering (including the over-allotment option) and has provided a \$5.0 million revolving credit facility to the Company. The credit facility bears interest at the 30 day LIBOR plus 300 basis points, payable monthly. In addition, the Company paid a one-time commitment fee equal to 0.5% of the full amount of the credit facility, and will pay a fee equal to 0.25% per annum on all amounts not drawn on the credit facility. To date, no amounts have been drawn on the credit facility.

Ventures has also provided cash collateral of \$5.0 million as required to support the foreign currency arrangement. Ventures received a fee equal to 1.0% of the amount of cash collateral provided at closing of the initial public offering on May 17, 2007. The cash collateral remains the property of Ventures and all income earned thereon is for the benefit of Ventures.

Included in accrued liabilities and other current liabilities is \$1.2 million related to deferred Northstar Subco monthly distributions to Ventures. The operating agreement of Northstar Subco provides that until the earlier of December 31, 2010 or an announced increase in monthly dividends by the Company, if the Company's cash available to pay dividends for any month is less than 110% of the initial full monthly dividend, Ventures' distributions from Northstar Subco shall be deferred by the shortfall. The Company's cash available to pay dividends for June, August, November, December 2007 and January, February, March, May and June 2008 was less than 110% of the initial full monthly dividends; accordingly, the payment of \$1.2 million of the distributions due to Ventures on account of its Northstar Subco Class B Units for those months has been deferred until twelve months following the month of deferral, provided at such time the Company's 12-month trailing cash available for dividends exceeds 110% of the initial full monthly dividend.

The Company provides management services to the Palladium for Surgery - Dallas and River Oaks Pain Management (the "Managed Centers"). The Palladium for Surgery – Dallas is located in Dallas Texas and began operations in 2005. River Oaks Pain Management consists of three pain management clinics located in Houston, Humble and Baytown, Texas. The Company's CEO owns a 50% interest in River Oaks Pain Management and together with certain members of management owns 95% of The Palladium for Surgery – Dallas. The Managed Centers are managed by the Company pursuant to a management agreement. The management agreement provides for a management fee of 10% of collected revenues.

In October, 2007, the Company acquired an option to acquire a 60% interest in The Palladium for Surgery – Dallas. In consideration for the option, the Company agreed to reduce the management fees it receives from The Palladium for Surgery - Dallas from 10% to 5.5% over the term of the option, upon the achievement of certain prescribed conditions. As of June 30, 2008, The Palladium for Surgery – Dallas had not met the prescribed conditions.

Revenue from management fees represents fees charged to the managed centers, based on a percent of collections, for managing the center's business operations. The revenue from these fees, included in net patient service revenues, was \$0.1 million and \$0.2 million for the three and six months ended June 30, 2008, respectively.

These transactions are measured at exchange amounts which represent the amount agreed upon by the parties.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Management estimates are required with respect to the valuation of financial instruments, acquired assets and liabilities, intangible assets, goodwill, accounts receivable, inventories and provisions for potential liabilities, determination of net patient service revenues and income tax provisions.

Net patient service revenues of the Company includes amounts for services billed to private insurance carriers, federal and state agencies and patients. Billed revenues are recorded net of the estimated contractual adjustments provided for under the various agreements with the majority of these third party payors. Management establishes the contractual allowance adjustments and allowances for doubtful accounts based on historical payment data, current economic conditions and other pertinent facts for each Northstar ASC. Management reviews and evaluates historical payment data and current economic conditions on a quarterly basis and adjusts its estimates as appropriate.

## **ADOPTING OF NEW ACCOUNTING STANDARDS AND DEVELOPMENTS**

### *Recent Accounting Pronouncements*

On January 31, 2008, the CICA issued a new accounting standard: Handbook Section 3064 Goodwill and Intangible Assets. Section 3064 replaces Handbook Section 3062 Goodwill and Other Intangible Assets and Handbook Section 3450 Research and Development Costs. Section 3064 establishes standards for recognition, measurement and disclosure of goodwill and intangible assets. This new standard will be effective for the Company in the first Quarter of 2009. The Company is currently evaluating the implications of this new standard.

In 2008, Canada's Accounting Standards Board ratified a strategic plan that will result in Canadian GAAP, as used by public companies, being converged with International Financial Reporting Standards over a transitional period currently expected to be about five years. The Company will be required to report using the converged standards effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The impact of this transition on the Company's consolidated financial statements has not yet been determined.

### *Adopting of New Accounting Standards and Developments*

Effective January 1, 2008, the Company adopted two new CICA standards related to the disclosure and presentation of financial instruments. Section 3862, Financial Instruments Disclosure and Section 3863, Financial Instruments

Presentation, replaced Section 3861 Financial Instruments Disclosure and Presentation. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentations requirements.

Effective January 1, 2008, the Company adopted Section 1535, “Capital Disclosures,”. This standard establishes standards for disclosing information about a Company’s capital and how it is managed in order that a user of the financial statements may evaluate the company’s objectives, policies, and processes for managed capital.

Effective January 1, 2008, the Company adopted Section 3031, “Inventories”, which is based on International Accounting Standard 2. Under the new standard, inventories are required to be measured at the “lower of cost and net realizable value”, which is different from the existing guidance of the “lower of cost and market”. The new standard also allows the reversal of any write-downs previously recognized.

## **MANAGEMENT’S RESPONSIBILITY FOR FINANCIAL REPORTING AND DISCLOSURE CONTROLS**

### **Internal Controls over Financial Reporting**

Disclosure controls and procedures within the Company are designed to provide reasonable assurance that all relevant information required to be disclosed in its annual and interim filings and other reports is recorded, processed, summarized and reported on a timely basis and is accumulated and communicated to the Northstar management.

The Company’s Chief Executive Officer (“CEO”) and Chief Financial Officer and Corporate Secretary (“CFO”) are responsible for establishing and maintaining the Company’s disclosure controls and procedures to provide reasonable assurance that all relevant information required to be disclosed is gathered and reported on a timely basis so that appropriate decisions can be made regarding public disclosure. It should be noted that while the CEO and CFO believe that disclosure controls and procedures can provide a reasonable level of assurance and they are effective, they do not expect that disclosure controls and procedures can prevent all errors and fraud. A control system, no matter how well designed or operated can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with Canadian GAAP focusing in particular on controls over information. Management is responsible for establishing and maintaining adequate internal controls over financial reporting. A control system, no matter how well conceived and operated, can provide only reasonable, and not absolute assurance that the objectives of the control system are met. Because of their inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. These weaknesses in internal controls over financial reporting result in a more than remote likelihood that a material misstatement would not be prevented or detected on a timely basis.

The CEO and CFO have designed such disclosure controls and procedures, or caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company, including its consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which the annual filings are being prepared. The CEO and CFO have evaluated the effectiveness of the Company’s disclosure controls and procedures and have concluded that they are adequate and effective as of June 30, 2008, based on such evaluation.

Common with many small businesses, such as the Northstar ASCs, lack of segregation of duties, weakness in control environment and IT general control processes have, to date, been identified as areas where weakness exist. The existence of these weaknesses is compensated by senior management monitoring. The Company is taking steps to augment and improve the design of procedures and controls impacting these areas of weakness over internal controls over financial reporting.

There has been no change in the design of the Company's internal control over financial reporting during the three and six months ended June 30, 2008, that would materially effect or are reasonably likely to materially effect the Company's internal control over financial reporting.

## **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

In the normal course of business, the Company is exposed to market risks arising from adverse changes in interest rates and the C\$/US\$ foreign currency exchange rate. Market risk is defined for these purposes as the potential change in the fair market value of financial assets and liabilities resulting from an adverse movement in these rates.

The Company is exposed to fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar because the Company's operations and earnings are in U.S. dollars and the dividends will be paid in Canadian dollars. In order to minimize the impact of fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar, NHC entered into Canadian dollar/U.S. dollar exchange contracts at a rate of US\$1 = C\$1.0888 until June 2012, US\$1 = C\$0.9840 for the period from July 2012 until December 2012, and US\$1 = C\$1.0003 for the period from January 2013 until June 2013 for the total amount anticipated for dividends to common shareholders. The agreements consist of monthly forward foreign exchange contracts, of which 60 are open as of June 30, 2008.

At June 30, 2008, NHC had unrealized foreign exchange gains on the open forward currency exchange contracts, which had a value of \$3.5 million based on the open spot rate as of June 30, 2008. If the Company had liquidated the contracts and realized a gain, it would be exposed to fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar with respect to the dividends to the common shareholders.

## **RISK FACTORS**

Please refer to the risk factors articulated in the Company's Annual Information Form, dated March 31, 2008, for a list of the significant risk factors to which the Company is exposed.

## **OUTSTANDING SHARE DATA**

At June 30, 2008, the Company had 13,900,852 Common Shares outstanding.

## **OUTLOOK**

Northstar's historical success is based on management's ability to recruit high volume surgeons to its facilities.

At the Palladium Partnership, the Company intends to build on the center's strong business base by continuing to add more contracted physicians to its current complement, thus enhancing revenue levels.

Northstar is also exploring the potential of converting some of the Palladium Partnership's current strong contracted physicians into partners. Typically, when physicians become partners in a center, they bring more volume to the facility and the surgery center also benefits from 100% of the payment from the payor. In addition, partner surgeons are motivated to recruit new contracted physicians to increase center revenues.

Another way that Northstar recruits physicians is through its training programs. At the Palladium Partnership two pain management physicians who trained at the facility are now generating very significant revenue levels. A third physician has recently graduated from training and a fourth is currently training. The Company intends to continue to promote this program.

At the Kirby Center, the payor mix, identified above, continues to be an issue for Northstar going into the second half of 2008. While the Company views its 2008 first half net patient service revenue as reflecting a baseline level, it expects the recovery in revenue at the facility to be gradual.

To offset the decline at Kirby in high reimbursement cases, Northstar is engaged in an initiative to significantly increase the number of active physicians and the case load at that Center. Since taking over the facility, Northstar has added 14 physicians who now account for approximately 8% of revenue, with a payor mix that is superior to that of the overall center. The Company expects their percentage of the business to increase.

Northstar also expects to add at least five more physicians to Kirby by year-end. This initiative is enhanced by the recent closure of two physician-owned facilities in the area. The addition of new contracted physicians is not expected to result in an immediate revenue increase, however. Typically, it is not until the physicians begin to see the financial and operating benefits -- over a couple of billing cycles -- that they begin to bring more cases to the facility.

Northstar is also committed to growth through acquisition. The Company has built up a scalable infrastructure to support a larger base of business and has identified clear acquisition criteria. During the past 12 months Northstar explored and negotiated with individual ASCs and multiple ASC companies. While none of these discussions led to a transaction that would have been accretive and increase shareholder value, the industry remains largely unconsolidated and Northstar is regularly reviewing opportunities

As disclosed in the Company's MD&A for the third quarter of 2007, actual collections at the Kirby Partnership for the year ended December 31, 2006, the three-month period ended March 31, 2007 and the 46-day period ended May 16, 2007 (the day immediately prior to the completion of the Company's initial public offering) were lower than the reported net patient service revenues for those periods. The Company is currently in discussions with the physician limited partners at the Kirby Partnership pursuing the recoupment from the physicians' escrow accounts of the difference between the reported net patient service revenues and the actual collections for these pre-IPO periods. In accordance with the escrow agreement, the escrow agent has been notified.

#### **ADDITIONAL INFORMATION**

Additional information relating to the Company, including the consolidated interim financial statements for the three and six months ended June 30, 2008, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

August 8, 2008