

Consolidated Financial Statements of



NORTHSTAR HEALTHCARE

**NORTHSTAR HEALTHCARE INC.**

For the Year Ended December 31, 2008 and From the Inception of Operations on May 17, 2007  
to December 31, 2007

Northstar Healthcare Inc.  
Consolidated Financial Statements

For the Year Ended December 31, 2008 and From the Inception of Operations on  
May 17, 2007 to December 31, 2007

**Contents**

Audited Consolidated Financial Statements	
Auditors' Report	
Consolidated Balance Sheets .....	1
Consolidated Statements of Operations and Comprehensive Income .....	2
Consolidated Statements of Deficit .....	3
Consolidated Statements of Cash Flows.....	4
Notes to Consolidated Financial Statements.....	5 -25



**BDO Dunwoody LLP**  
Chartered Accountants  
And Advisors

Royal Bank Plaza  
P.O. Box 32  
Toronto Ontario Canada M5J 2J8  
Telephone: (416) 865-0200  
Telefax: (416) 865-0887  
[www.bdo.ca](http://www.bdo.ca)

---

## Auditors' Report

---

### To the Shareholders of Northstar Healthcare Inc.

We have audited the consolidated balance sheets of Northstar Healthcare Inc. as at December 31, 2008 and 2007, and the consolidated statements of operations and comprehensive income, deficit, and cash flows for the periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007, and the results of its operations and its cash flows for the periods then ended in accordance with Canadian generally accepted accounting principles.

*BDO Dunwoody LLP*

Chartered Accountants, Licensed Public Accountants

Toronto, Ontario  
March 26, 2009

# NORTHSTAR HEALTHCARE INC.

## Consolidated Balance Sheets

(in thousands of U.S. dollars)

	December 31, 2008	December 31, 2007
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents .....	\$ 3,733	\$ 4,983
Accounts receivable .....	8,366	13,861
Medical supplies.....	575	507
Prepaid expenses and other current assets.....	1,258	668
	13,932	20,019
Long term		
Property and equipment (Note 6) .....	4,658	5,561
Foreign currency exchange contracts (Note 7).....	-	5,467
Intangible assets (Note 8).....	1,658	9,076
Goodwill (Note 3 and 9).....	15,300	139,443
Other assets .....	35	43
	21,651	159,590
<b>Total assets</b> .....	<b>\$ 35,583</b>	<b>\$ 179,609</b>
<b>LIABILITIES</b>		
<b>Current liabilities:</b>		
Accounts payable .....	\$ 1,185	\$ 1,075
Accrued liabilities and other current liabilities.....	1,395	2,653
Dividends payable .....	659	1,402
Income tax payable.....	410	227
	3,649	5,357
Accrued liabilities (Note 10).....	1,718	-
Future income tax liability (Note 11).....	-	3,991
Foreign currency exchange contracts (Note 7).....	4,750	-
Other liabilities, non-controlling interest (Note 12).....	3,400	28,200
	9,868	32,191
<b>Total liabilities</b> .....	<b>13,517</b>	<b>37,548</b>
Non-controlling interests (Note 13) .....	7,072	9,394
<b>Shareholders' equity</b>		
Share capital (Note 14).....	139,718	139,718
Contributed surplus (Note 17).....	228	-
Deficit.....	(124,952)	(7,051)
<b>Total shareholders' equity</b> .....	<b>14,994</b>	<b>132,667</b>
<b>Total liabilities and shareholders' equity</b> .....	<b>\$ 35,583</b>	<b>\$ 179,609</b>

On behalf of the Board:

(Signed) Robert P. Kanee

Robert P. Kanee

(Signed) Victor Wells

Victor Wells

*The accompanying notes are an integral part of the consolidated financial statements.*

## NORTHSTAR HEALTHCARE INC.

### Consolidated Statements of Operations and Comprehensive Income

(in thousands of U.S. dollars, except per share amounts)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

	<b>Year Ended December 31, 2008</b>	<b>Period from May 17, 2007 to December 31, 2007</b>
<b>Net patient service revenue</b> .....	\$ 42,779	\$ 32,919
<b>Operating expenses</b>		
Salaries and benefits .....	6,674	3,853
Drugs and supplies.....	4,038	2,528
General and administrative .....	7,761	4,136
Bad debt.....	5,735	-
Depreciation and amortization.....	1,783	1,079
	25,991	11,596
<b>Income from operations</b> .....	<b>16,788</b>	<b>21,323</b>
<b>Other expense (income)</b>		
Distributions, other liabilities, non-controlling interest (Note 12)....	1,384	1,088
Withholding taxes.....	853	857
Change in fair value, other liabilities, non-controlling interest (Note 12).....	(24,800)	10,236
Loss (gain) on foreign currency.....	8,809	(6,003)
Goodwill and intangible impairment .....	131,141	-
State franchise tax.....	301	225
Other income .....	(72)	(82)
	117,616	6,321
<b>Income (loss) before income taxes and non-controlling interests .....</b>	<b>(100,828)</b>	<b>15,002</b>
<b>Income tax expense (recovery) (Note 11)</b>		
Current.....	459	227
Future.....	(3,991)	3,991
	(3,532)	4,218
<b>Non-controlling interests (Note 13) .....</b>	<b>6,910</b>	<b>7,624</b>
<b>Net income (loss) and comprehensive income (loss) .....</b>	<b>\$ (104,206)</b>	<b>\$ 3,160</b>
Net income (loss) per common share (basic).....	<b>\$ (7.50)</b>	<b>\$ 0.23</b>
Net income (loss) per common share (fully diluted) .....	<b>\$ (7.50)</b>	<b>\$ 0.23</b>
Weighted average shares outstanding – basic.....	13,900,852	13,749,756
Weighted average shares outstanding – fully diluted .....	13,900,852	13,749,756

*The accompanying notes are an integral part of the consolidated financial statements.*

# NORTHSTAR HEALTHCARE INC.

## Consolidated Statements of Deficit

(in thousands of U.S. dollars)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

	<b>Year Ended December 31, 2008</b>	<b>Period from May 17, 2007 to December 31, 2007</b>
<b>Deficit, beginning of period</b> .....	\$ (7,051)	\$ -
Net (loss) income.....	(104,206)	3,160
Dividends.....	(13,695)	(10,211)
<b>Deficit, end of period</b> .....	<u>\$ (124,952)</u>	<u>\$ (7,051)</u>

*The accompanying notes are an integral part of the consolidated financial statements.*

# NORTHSTAR HEALTHCARE INC.

## Consolidated Statement of Cash Flows

(in thousands of U.S. dollars)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	<b>Year Ended December 31, 2008</b>	<b>Period from May 17, 2007 to December 31, 2007</b>
Net (loss) income .....	\$ (104,206)	\$ 3,160
Adjustments to reconcile net income to net cash provided by operating activities:		
Goodwill and intangible impairment .....	131,141	-
Loss on sale of capital assets .....	7	-
Share unit plan compensation expense .....	228	-
Depreciation and amortization .....	1,783	1,079
Future income tax expense (recovery) .....	(3,991)	3,991
(Gain) loss on foreign currency exchange contracts .....	9,505	(6,003)
Non-controlling interests .....	6,910	7,624
Change in fair value of other liabilities, non-controlling interest .....	(24,800)	10,236
Changes in operating assets and liabilities .....	5,601	(1,782)
Cash flows provided by operating activities .....	<u>22,178</u>	<u>18,305</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Business acquisition, net of cash acquired of \$999 .....	-	(138,719)
Purchase of property and equipment .....	(467)	(346)
Cash flows used in investing activities .....	<u>(467)</u>	<u>(139,065)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Initial public offering and over-allotment proceeds of common shares, net of expenses .....	-	139,718
Distributions to non-controlling interest .....	(9,233)	(5,702)
Dividends paid .....	(13,712)	(8,273)
Realized foreign exchange gain on dividends paid .....	(727)	-
Proceeds on sale of foreign currency exchange contracts .....	711	-
Cash flows used in/provided by financing activities .....	<u>(22,961)</u>	<u>125,743</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS .....</b>	<b>(1,250)</b>	<b>4,983</b>
<b>CASH AND CASH EQUIVALENTS, beginning of period .....</b>	<b>4,983</b>	<b>-</b>
<b>CASH AND CASH EQUIVALENTS, end of period .....</b>	<b>\$ 3,733</b>	<b>\$ 4,983</b>
 <b>Supplemental cash flow information</b>		
Cash paid for income taxes .....	\$ 1,512	\$ -

*The accompanying notes are an integral part of the consolidated financial statements.*

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

References in these financial statements to “we” and “our” are to Northstar Healthcare Inc. (the “Company” or “NHC”) and its subsidiaries as applicable. The Company was incorporated under the *Business Corporations Act* (British Columbia) on March 16, 2007 and commenced operations following the completion of its initial public offering on May 17, 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 its initial public offering to indirectly acquire a 70% partnership interest in The Palladium for Surgery–Houston, L.P. (the “Palladium Partnership”) and a 60% partnership interest in Medical Ambulatory Surgical Suites, L.P. (the “Kirby Partnership” and together with the Palladium Partnership, the “Northstar Partnerships”), which operate two ambulatory surgery centres (the “Northstar ASCs”) located in Houston. In addition, NHC manages an ambulatory surgery centre in Dallas and two pain management clinics in Houston.

### Note 1. Significant Accounting Policies and Practices

The consolidated financial statements of the Company are prepared in accordance with Canadian Generally Accepted Accounting Principles (“Canadian GAAP”). The Company’s functional and reporting currency is U.S. dollars; therefore all amounts are in U.S. dollars, unless otherwise noted.

(a) Principles of Consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries. We consolidate when we can exercise control over operations and policies of an entity. When we consolidate, we combine the accounts of our subsidiaries with our accounts, and eliminate intercompany balances and transactions.

(b) Use of Accounting Estimates

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

Retroactively calculated third-party contractual adjustments are accrued on an estimated basis in the period the related services are rendered. Net patient service revenue is adjusted as required in subsequent periods based on final settlements and collections.

(c) Foreign Exchange

We pay all cash dividends to common shareholders in Canadian dollars, but the Company’s revenues and cash flows are generated in the United States. Therefore we are subject to foreign exchange exposure. We use foreign currency forward contracts to manage the foreign currency fluctuations related to the payment of cash dividends to common shareholders. However, our ability to extend or renegotiate these contracts as necessary depends on our future operating performance and cash flows, which are subject to economic conditions, interest rate levels and financial, competitive, business and other factors, many of which are beyond our control.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 1. Significant Accounting Policies and Practices (continued)

The consolidated financial statements have been prepared in U.S. dollars. From time to time assets and liabilities may be denominated in foreign currency and, if so, will be translated at the exchange rate in effect at the balance sheet date, with resulting gains or losses included in net income.

Dividends of the Company are announced monthly, with the date of record generally falling on the last day of the calendar month. At the date of record, the Company records a liability based on the amount of U.S. dollars required to pay the declared dividends using the Canadian to U.S. dollar foreign exchange spot rate. The difference between the spot rate and the exchange rate under the Company's currency instruments is recognized in gain or loss on foreign currency

#### (d) Cash and Cash Equivalents

We maintain our cash in bank deposit accounts that at times, may exceed U.S. and Canadian federally insured limits. We have not experienced any losses in such accounts, and we believe we are not exposed to any significant credit risks on cash equivalents.

For purposes of balance sheet presentation and reporting our cash flows, we define cash equivalents as highly liquid investments that mature in three months or less from the date of purchase.

#### (e) Accounts Receivable

On a periodic basis, we evaluate our accounts receivables based on the history of past write-offs and collections and current credit conditions and adjust the carrying value accordingly. An account is written off when it is determined that all collection efforts have been exhausted. The Company does not accrue finance or interest charges.

An allowance for uncollectible patient receivables balances is maintained at a level which the Company believes is adequate to absorb probable losses. The Company determines the adequacy of the allowance based on historical data, current economic conditions and other pertinent factors for the respective Center and its payors.

#### (f) Medical Supplies

Medical supplies consist of various surgical supplies and medications and are valued at the lower of cost and net realizable value on the first-in, first-out method. The Company had no write-down or reversals of write-down for medical supplies for the year ended December 31, 2008.

#### (g) Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the useful lives of the related assets. Leasehold improvements are amortized over the lesser of the estimated useful life of the asset or the term of the lease. Maintenance and repairs are charged to operations when incurred.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 1. Significant Accounting Policies and Practices (continued)

The estimated useful lives for depreciation and amortization purposes are:

<u>Assets</u>	<u>Estimated Useful Lives</u>
Telephone equipment.....	7 Years
Computer hardware.....	5 Years
Computer software.....	3 – 5 years
Furniture and office equipment.....	7 Years
Medical equipment.....	5 Years
Leasehold improvements.....	Lease term

#### (h) Goodwill and Indefinite Life Intangibles

Goodwill represents the difference between the price we paid for our interests in the Northstar Partnerships, using the purchase method of accounting, and the fair value of the net tangible assets and identifiable intangible assets we acquired. We test goodwill for impairment at least annually, utilizing several testing methods.

Indefinite life intangibles assets represent the fair value of Medicare licenses that we obtained when we acquired our interests in the Northstar Partnerships. Medicare licenses are an indefinite life intangible asset, and are thus not amortizable.

When evaluating whether goodwill and indefinite life intangibles are impaired, we compare the fair value of the reporting units to its carrying amount, including goodwill and indefinite life intangibles. If the carrying amount exceeds the fair value, then the amount of the impairment loss must be measured. The amount of an impairment loss is calculated by comparing the implied fair value of goodwill and indefinite life intangibles to their carrying value.

#### (i) Intangible Assets

Intangible assets also include the value of non-compete agreements which are amortized on a straight line basis over their estimated life of two years.

#### (j) Asset Impairment

We monitor events and changes in circumstances which may require us to review the carrying value of our property and equipment and intangible assets. We assess impairment of our property and equipment and intangible assets based on estimated undiscounted future operating cash flows.

We measure impairment, if any, by comparing the carrying value of an asset to its fair value. We recognize an impairment loss if the carrying value exceeds the fair value.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 1. Significant Accounting Policies and Practices (continued)

The evaluation of asset impairment requires us to make assumptions about future cash flows over the life of the asset being evaluated. These assumptions require significant judgment, and actual results may differ from assumed and estimated amounts.

#### (k) Net Patient Service Revenue

Net patient service revenue is reported at the estimated collectible amounts from patients, third-party payors, and others for services rendered.

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.

We monitor historical collections and market conditions to report the effects of a change in estimates. Revenue is recognized upon the performance of the patient service.

#### (l) Management Fees Revenue

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 management agreements provide for a management fee of 10% of collected revenues. Management fees revenue is revenue earned for services under the Management and Cost Sharing Agreements between Northstar Healthcare Acquisitions, L.L.C. ("Northstar Acquisitions") and both of the Northstar Partnerships and for services provided to other clients of Northstar Acquisitions. 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 two pain management clinics located in Houston and Baytown, Texas.

#### (m) Income Taxes

We use the asset and liability method to account for income taxes. Under the asset and liability method future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts and their respective tax basis.

We measure future income tax assets and liabilities using income tax rates that we expect to apply to taxable income in the years when we expect those differences to be recovered or settled. We recognize the effect of a change in tax rates on future income tax assets and liabilities in income in the period that the rate change is effective.

We establish valuation allowances when necessary to reduce future income tax assets to the amount that is more likely than not to be realized.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 1. Significant Accounting Policies and Practices (continued)

(n) Net Income Per Common Share

We calculate net income per common share by dividing net income available for common shareholders by the weighted average number of common shares outstanding during the period. Fully diluted income per share is computed using the weighted average number of common and potential common shares outstanding during the year. Potential common shares includes shares granted under the Company's Deferred Share Unit Plan and Restricted Share Unit Plan.

(o) Deferred Share Unit Plan

We maintain a Deferred Share Unit Plan (the "DSU Plan") as compensation for independent members of the Board of Directors. Each Director, in addition to allocated deferred share units ("DSUs"), may receive any or all of their retainer fees in DSUs under the plan. Effective June 5, 2008, these units may be settled in cash or common shares at the discretion of the board. As such, they are accounted for as equity instruments in the period in which the DSUs are granted. Prior to June 5, 2008, the DSU Plan provided that DSUs were to be settled in cash; accordingly they were accounted for as liabilities and marked-to-market on each reporting date with changes in market value being charged to operations. In addition, we recognize the issuance of additional DSUs to reflect the payment of cash dividends on our common shares under the DSU Plan as an expense.

(p) Restricted Share Unit Plan

We maintain a Restricted Share Unit Plan (the "RSU Plan") for employees. Under the RSU Plan, restricted share units ("RSUs") may be granted to employees of Northstar Acquisitions at the sole discretion of the Board. As these units can be settled in cash or common shares, they are accounted for as equity instruments with the resulting expense recorded over the vesting period of the RSUs. In addition, we recognize the issuance of additional RSUs to reflect the payment of cash dividends on our common shares under the RSU Plan as an expense.

(q) Recent Accounting Pronouncements

- (i) 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. Canada's Accounting Standards Board (AcSB) also made an amendment to Section 1000, Financial Statement Concepts to delete guidance previously interpreted to support the appropriateness of deferral of costs. In the past, expenses would be deferred on the basis of the matching principle. Going forward, expenses can only be capitalized if they meet the definition of an asset or the criteria for recognition. 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.
- (ii) 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 Company is monitoring the impact of this transition on the consolidated financial statements.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 1. Significant Accounting Policies and Practices (continued)

- (iii) Section 1582, Business Combinations. This new Section replaces Section 1581 and will be applicable to business combinations for which the acquisition date is on or after the Company's interim and fiscal year beginning January 1, 2011. Early adoption is permitted. This section improves the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. The Company is currently evaluating the implications of this new standard.
- (iv) Section 1601, Consolidated financial statements. These new Sections will be applicable to financial statements relating to the Company's interim and fiscal year beginning on or after January 1, 2011. Early adoption is permitted. This section establishes standards for the preparation of consolidated financial statements. The Company is currently evaluating the implications of this new standard.
- (v) Section 1602, Non-Controlling interests. This new Section will be applicable to financial statements relating to the Fund's interim and fiscal year beginning on or after January 1, 2011. Early adoption is permitted. This section establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The Company is currently evaluating the implications of this new standard. Section 1601 and 1602 replaced Section 1600, the previous consolidated financial statements section.

### Note 2. Adoption of New Accounting Standards and Developments

- (a) 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 presentation requirements. (Note 5).
- (b) 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 (Note 4).
- (c) 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. (Note 1f).
- (d) Effective January 1, 2008, the Company adopted the amended CICA Handbook Section 1400, "General Standards of Financial Statement Presentation". This revised standard requires management to assess the Company's ability to continue as a going concern and to disclose any material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The adoption of this revised standard had no impact on the Company's presentation of its financial position.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 3. Business Acquisition

In 2007, the Company received \$139,718 in net proceeds from its initial public offering (including the over-allotment option), after deducting fees payable by NHC to the underwriters and the expenses of the offering which totalled \$13,858.

The net proceeds were used to acquire all of the Class A Units and indirectly acquire all of the Preferred Units and Common Units of Northstar Acquisitions. All of the Class B Units of Northstar Acquisitions are held by Healthcare Ventures, Ltd. ("Ventures").

On closing of NHC's initial public offering, Northstar Acquisitions used a portion of the proceeds from the sale of its equity interests to acquire all of the Preferred Units and Class A Units of Northstar Healthcare Subco, L.L.C. ("Northstar Subco").

Northstar Subco used a portion of these proceeds to indirectly acquire a 70% partnership interest, including the general partnership interest, in the Palladium Partnership and a 60% partnership interest, including the general partnership interest, in the Kirby Partnership.

Results from operations from these acquisitions have been included in the results of operations for the period from the date of acquisition.

The acquisition was accounted for using the purchase method. The purchase price of \$139,718 was allocated to the assets and liabilities of the Northstar Partnerships as follows:

#### Net assets acquired at fair value

Cash and cash equivalents .....	999
Accounts receivable .....	10,921
Medical supplies .....	530
Prepaid expenses and other current assets .....	1,595
Accounts payable .....	(874)
Accrued liabilities and other current liabilities .....	(2,621)
Property and equipment .....	6,031
Other long-term assets .....	15
Non-compete agreements .....	841
Medicare licenses .....	8,498
Other liabilities – non-controlling interest .....	(17,964)
Non-controlling interests .....	(7,696)
	<hr/>
	275
Goodwill .....	139,443
	<hr/>
	\$ 139,718

In the fourth quarter of 2007, the Company completed its fair value assessment of the acquired net assets, resulting in an adjustment to current assets less current liabilities, non-controlling interests, intangibles and goodwill. Also see Note 8 and 9.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 4. Capital Disclosures

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue the development of its services and to maintain a flexible capital structure that optimizes the costs of capital at an acceptable risk.

In the management of capital, the Company includes the components of shareholders' equity as well as the non-controlling interests and the other liabilities, non-controlling interest. For the year ended December 31, 2008, the Company has shareholders' equity of \$15.0 million, non-controlling interests of \$7.1M and other liabilities, non-controlling interest of \$3.4 million. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents.

The Company is not subject to any externally imposed capital requirements and there was no change with respect to the overall capital risk management strategy during the year ended December 31, 2008.

### Note 5. Financial Instruments

In common with all other businesses, the Company is exposed to risks that arise from its use of financial instruments. This note describes the Company's objectives, policies and processes for managing those risks and the methods used to measure them. Further quantitative information in respect of these risks is presented throughout these financial statements.

#### *Principal financial instruments*

The principal financial instruments used by the Company, from which financial instrument risk arises, are as follows:

- Cash and cash equivalents; held for trading carried at fair value
- Accounts receivable; loans and receivable carried at amortized cost
- Accounts payable, accrued liabilities and other liabilities; other liabilities carried at amortized cost
- Foreign currency exchange contracts; derivative carried at fair value
- Dividends payable; other liabilities carried at amortized cost
- Other liabilities, non-controlling interest; other liability carried at fair value.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 5. Financial Instruments (continued)

#### *Financial instruments - risk management*

The Company is exposed through its operations to the following financial risks:

- Credit risk
- Fair value or cash flow interest rate risk
- Foreign exchange risk
- Other market price risk
- Liquidity risk

#### *General objectives, policies and processes*

The Board has overall responsibility for the determination of the Company's risk management objectives and policies related to financial instruments and, while retaining ultimate responsibility for them, it has delegated the authority for designing and operating processes that ensure the effective implementation of the objectives and policies to the Company's finance function. The Board receives reports from the Company's Chief Financial Officer through which it reviews the effectiveness of the processes put in place and the appropriateness of the objectives and policies it sets. The overall objective of the Board is to set policies that seek to reduce risk as far as possible without unduly affecting the Company's competitiveness and flexibility.

#### *Credit risk*

Credit risk is the risk of financial loss to the Company if a patient or insurance company fails to meet its contractual obligations. The Company, in the normal course of business, is exposed mainly to credit risk on its accounts receivables from insurance companies, other third-party payors, and doctors. Accounts receivables are net of applicable bad debt reserves, which are established based on specific credit risk associated with insurance companies and payors and other relevant information.

Credit risk also arises from cash and cash equivalents and deposits with banks and financial institutions. For banks and financial institutions, only independently rated parties with minimum rating "A" are accepted. The Company does not enter into derivatives to manage credit risk.

Revenues and related accounts receivable is reported at estimated collectible amounts which is based on management's evaluation of historical payment rates, payor mix and current economic conditions. A 5.0% change in the estimated collectible rates would result in a decrease/increase in pre-tax profit and net assets of \$2.1 million.

#### *Market risk*

Market risk is the risk to the Company that the fair value of future cash flows of financial instruments will fluctuate due to changes in interest rates and foreign currency exchange rates.

#### *Foreign exchange risk*

Foreign exchange risk arises because the Company has operations located in the United States and pays its monthly dividends in Canadian Dollars.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### **Note 5. Financial Instruments (continued)**

The Company has entered into foreign currency exchange contracts to hedge the Company's exposure to fluctuations in the exchange rate between U.S. and Canadian currencies, which arises from the payment of dividends on its common shares. The Company recognizes gain or loss from any differences between the Canadian to US dollar foreign exchange spot rate and the exchange rate under the Company's currency instruments as incurred.

As of December 31, 2008, the Company is committed to deliver approximately \$0.8 million monthly in exchange for approximately C\$0.9 million for the contract period of January 2009 to June 2012, \$0.9 million monthly in exchange for approximately C\$0.9 million for the contract period of July 2012 to June 2013 at stipulated exchange rates (Note 7).

The effect of a 20.0% strengthening of the Canadian dollar against the U.S. dollar, as of December 31, 2008, on the forward currency swaps carried at that date would, all other variables held constant, have resulted in an increase in pre-tax profit for the year and increase in net assets of \$9.4 million. A 20.0% weakening in the exchange rate would, on the same basis, have decreased pre-tax profit and decreased net assets by \$6.1 million. The Company is also exposed to currency risk on purchases made from vendors based in Canada. As of December 31, 2008, the Company had trade payables of \$0.2 million denominated in Canadian Dollars.

#### *Interest rate risk*

Since the Company does not have any long term debt, it does not have any exposure to interest rate risk.

#### *Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due and arises from the Company's management of working capital. The Company's objective to managing liquidity risk is to ensure that it will have sufficient cash to allow it to meet its liabilities when they become due. To achieve this objective, it seeks to maintain cash balances (or agreed facilities) to meet expected requirements and dividend payments, which ended December 31, 2008. The liquidity risk of the Company and its subsidiaries is managed centrally by the Company's finance function.

## NORTHSTAR HEALTHCARE INC.

### Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

#### Note 6. Property and Equipment

Item	<b>December 31, 2008</b>		
	Cost	Accumulated Depreciation	Net Book Value
Telephone equipment .....	\$ 27	\$ 11	\$ 16
Computer hardware .....	223	70	153
Computer software .....	119	72	47
Furniture and office equipment .....	235	74	161
Medical equipment .....	3,557	1,360	2,197
Leasehold improvements .....	2,666	582	2,084
Totals .....	\$ 6,827	\$ 2,169	\$ 4,658

Item	<b>December 31, 2007</b>		
	Cost	Accumulated Depreciation	Net Book Value
Telephone equipment .....	\$ 26	\$ 6	\$ 20
Computer hardware .....	160	24	136
Computer software .....	119	33	86
Furniture and office equipment .....	194	27	167
Medical equipment .....	3,212	503	2,709
Leasehold improvements .....	2,666	223	2,443
Totals .....	\$ 6,377	\$ 816	\$ 5,561

The depreciation expense charged to operations was \$1.4 million for the year ended December 31, 2008, and \$0.8 million for period since inception of operations on May 17, 2007 to December 31, 2007.

The comparative values for property and equipment as of December 31, 2007 were revised to be consistent with current allocations with no impact on Net Book Value.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 7. Foreign Currency Contracts, Reporting Currency and Foreign Currency Translation

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 December 31, 2008, the Company is committed to deliver approximately \$0.8 million monthly in exchange for approximately C\$0.9 million for the contract period of January 2009 to June 2012 and \$0.9 million monthly in exchange for approximately C\$0.9 million for the contract period of July 2012 to June 2013, at stipulated exchange rates as follows:

Contract Dates	US\$ to be delivered	Cdn\$ to be received	Cdn\$ per US\$
January 2009 – June 2012	33,174	36,120	1.0888
July 2012 – December 2012	5,244	5,160	0.9840
January 2013 – June 2013	5,158	5,160	1.0003

The fair value of the Company's foreign currency contracts was a \$4.8 million unrealized loss at December 31, 2008 and a \$5.5 million unrealized gain at December 31, 2007. Changes in the fair value during each reporting period are recorded as loss or gain on foreign currency.

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 in loss or gain on foreign currency. The gain recognized was \$0.7 million for year ended December 31, 2008 and \$0.5 million for the period from inception of operations on May 17, 2007 to December 31, 2007.

On September 30, 2008, the Company sold approximately 40% of its existing foreign currency exchange contracts for proceeds of \$0.7 million.

### Note 8. Intangible Assets

Listed below are the identifiable intangible assets recognized upon the acquisition of the Northstar Partnerships. The Company engaged an independent valuation firm to determine the acquisition fair value of its identifiable intangible asset values during the fourth quarter of 2007.

Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. On September 22, 2008, the Company announced a reduction in the monthly dividend to shareholders from C\$0.10 to C\$0.058, effective for the September 2008 dividend. In addition, on January 12, 2009, the Company announced that it was experiencing difficulties with payments by one of its key third party payors at the Palladium ASC, and was suspending the Company's dividend.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 8. Intangible Assets (continued)

As a result of the unfavourable operating conditions such as payor problems, increasing competitive pressures and worsening economic outlook for the near term, the Company performed an impairment test in connection with the preparation of our consolidated financial statements for the year ended December 31, 2008. The Company engaged an independent valuation firm to determine if goodwill and intangible assets were impaired, based primarily on discounted cash flows. Based on the assessment as of December 31, 2008, the Company determined that the carrying value of the Medicare licenses intangible exceeded its estimated fair value and recorded a \$7.0 million pre-tax impairment charge.

Intangible assets consists of the following:

Intangible assets	December 31, 2008			
	Cost	Accumulated Amortization	Impairment Write-down	Net Book Value
Medicare licenses .....	\$ 8,498	\$ -	\$ 6,998	\$ 1,500
Non-compete agreements .....	841	683	-	158
Totals.....	\$ 9,339	\$ 683	\$ 6,998	\$ 1,658

Intangible assets	December 31, 2007		
	Cost	Accumulated Amortization	Net Book Value
Medicare licenses .....	\$ 8,498	\$ -	\$ 8,498
Non-compete agreements .....	841	263	578
Totals.....	\$ 9,339	\$ 263	\$ 9,076

Intangible assets include the value of Medicare licenses and non-compete agreements. Medicare licenses are an indefinite life intangible asset, and are thus not amortizable. The non-compete agreements are amortized over their estimated useful life of two years. Amortization for the period was \$0.4 million for the year ended December 31, 2008 and \$0.3 million from inception of operations on May 17, 2007 to December 31, 2007.

### Note 9. Goodwill

Goodwill represents the difference between business acquisitions costs, using the purchase method of accounting, and the fair value of the net tangible assets and identifiable intangible assets acquired. Under Canadian GAAP, goodwill is not amortized but is subject to an annual impairment test based on a two-step impairment approach used to identify potential goodwill impairment.

Since March 2008, management has closely monitored trends in budget to actual results on a quarterly basis to determine if an impairment trigger was present that would warrant a reassessment of the recoverability of the carrying amount of goodwill prior to the required annual impairment test. On September 22, 2008, as a result of the continued impact in the negative shift in payor mix, which resulted in lower than forecasted net patient service revenues and cash flow generation, the Company announced a reduction in the monthly dividend to shareholders from C\$0.10 to C\$0.058, effective for the September 2008 dividend. In addition, on January 12, 2009, the Company announced that it was experiencing difficulties with payments by one of its key third party payors at the Palladium ASC, and was suspending the Company's dividend.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 9. Goodwill (continued)

As a result of these unfavorable and uncertain operating conditions and the near term outlook, the Company performed an impairment test in connection with the preparation of our consolidated financial statements for the year ended December 31, 2008. The Company engaged an independent valuation firm, based primarily on discounted cash flows, to determine if goodwill was impaired. Based on this assessment as of December 31, 2008, management determined that the carrying value of goodwill exceeded its estimated fair value and recorded a total of \$124.1 million pre-tax impairment charge for the year.

Goodwill consists of the following:

<u>Goodwill</u>	<u>December 31, 2008</u>	<u>December 31, 2007</u>
Opening balance .....	\$ 139,443	\$ -
Goodwill on initial public offering .....	-	139,443
Goodwill impairment.....	(124,143)	-
Total .....	<u>\$ 15,300</u>	<u>\$ 139,443</u>

### Note 10. Related Parties

Physicians who hold a non-controlling interest in the Northstar Partnerships routinely provide independent professional services directly to patients utilizing the Northstar ASCs (See Note 12). In addition, Donald Kramer, M.D., who resigned as a director of the Company on February 9, 2009, owns approximately 18.0% of the Palladium Partnership.

Donald Kramer, M.D., is the sole limited partner of Ventures. Ventures holds all of the Northstar Acquisitions Class B Units. Each Northstar 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 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 Northstar Acquisitions Preferred Units and Northstar Acquisitions Class A Units. The specified percentage is currently equal to 12.5% and will decrease if Ventures disposes of Northstar Acquisitions Class B Units pursuant to its negotiation right (See Note 12).

Ventures also holds all of the Northstar Subco Class B Units. Each Northstar 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 Northstar Subco Class A Units; provided that 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 has provided a \$5.0 million revolving credit facility to Northstar Subco. The credit facility bears interest at the 30 day LIBOR plus 300 basis points, payable monthly. In addition, the Company has accrued 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.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 10. Related Parties (continued)

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 shall remain the property of Ventures and all income earned thereon shall be for the benefit of Ventures.

Included in accrued liabilities as of December 31, 2008 is \$1.7 million related to deferred Northstar Subco monthly distributions to Ventures, compared to \$0.5 million as of December 31, 2007. 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 and December 2007 and January, February, March and May to December 2008 was less than 110% of the initial full monthly dividends; accordingly, the payment of \$1.7 million of the distributions due to Ventures on account of its Northstar Subco Class B Units has been deferred until twelve months following the month of each 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, through Northstar Acquisitions, 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 two pain management clinics located in Houston and Baytown, Texas. Dr. Kramer 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.

Revenue from management fees represents fees charged to the Managed Centers, based on a percent of collections, for managing the centres' business operations. The revenue from these fees was \$0.4 million for the year ended December 31, 2008 and \$0.4 million from the inception of operations on May 17, 2007 to December 31, 2007.

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

### Note 11. Income Taxes

#### (a) Reconciliation of Reported Income Tax Expense to Expected Income Tax Expense

The following table shows the reconciliation between income tax expense reported in our consolidated statements of operations and the income tax expense that would have resulted from applying the United States federal income tax rate of 35% to pre-tax income.

We have reduced our taxable income and therefore, our calculation of income tax expense, by interest expense on the Company's intercompany notes. These intercompany notes bear interest at 11.1% and are eliminated on consolidation. The interest expense on these notes was \$6.9 million for the year ended December 31, 2008 and \$7.7 million from the inception of operations on May 17, 2007 to December 31, 2007.

## NORTHSTAR HEALTHCARE INC.

### Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

#### Note 11. Income Taxes (continued)

	<b>Year Ended December 31, 2008</b>	<b>Period from May 17, 2007 to December 31, 2007</b>
Income (loss) before income taxes and non-controlling interests.....	\$ (100,828)	\$ 15,002
U.S. federal income tax rate.....	35%	35%
Expected U.S. federal income tax expense (recovery).....	(35,290)	5,251
Reconciling Items:		
Valuation allowance.....	42,924	-
Inter-company note interest expense.....	(2,398)	(2,290)
Change in fair value of non-controlling interest.....	(8,680)	3,583
Unrealized gain on foreign currency.....	-	-
Non-controlling interest.....	(2,251)	(2,668)
Operating loss carry-forward not recorded.....	698	-
Prior year tax expense.....	662	-
Distribution, other liabilities non-controlling interest.....	416	-
Other.....	387	342
Total income taxes.....	\$ (3,532)	\$ 4,218

(b) Future Income Tax

The table below sets forth the tax effects of temporary differences that give rise to significant portions of the future income tax assets and future income tax liabilities that are reported in our Consolidated Balance Sheets.

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
Future income tax (liabilities) assets:		
Gain on foreign currency.....	\$ 1,663	\$ (1,913)
Goodwill.....	38,927	(2,034)
Intangibles.....	2,334	(44)
U.S. valuation allowance.....	(42,924)	-
Interest carry-forward.....	1,153	-
Non-capital losses.....	1,881	-
Share issuance costs.....	1,813	-
Canadian valuation allowance.....	(4,847)	-
Net future income tax (liabilities) assets.....	\$ -	\$ (3,991)

The Company has non-capital losses of \$2.2 million and \$4.3 million that expire in 2027 and 2028, respectively. In addition, the Company has \$3.3 million in interest carry-forwards which have no expiration date.

## **NORTHSTAR HEALTHCARE INC.**

### **Notes to Consolidated Financial Statements**

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

#### **Note 12. Other Liabilities, Non-Controlling Interest**

In connection with the Company's initial public offering, Ventures has the right exercisable at any time after the second anniversary of closing of the initial public offering (but not more frequently than once in any six-month period) to request in writing that Northstar Subco enter into good faith negotiations with Ventures to purchase for cancellation all or any portion of the Northstar Subco Class B Units 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 Northstar Acquisitions Class B Units. Northstar Acquisitions will purchase for cancellation all outstanding Northstar Acquisitions Class B Units for a nominal amount on the date that all outstanding Northstar Subco Class B Units have been purchased for cancellation by Northstar Subco.

If within 60 days of receipt of the request by Ventures to purchase the Northstar Subco Class B Units, Northstar Subco; (i) does not use its best efforts to negotiate the purchase for cancellation the Northstar Subco Class B Units, or (ii) Northstar Subco has used its best efforts to negotiate the purchase and the Company fails to agree on a purchase price, or (iii) within 60 days of the request, Northstar Subco offers to purchase Northstar Subco Class B Units and such offer is accepted by Ventures, and the purchase pursuant to such offer does not close within 90 days, Ventures shall be entitled to an enhanced distribution. The enhanced distribution shall be paid to Ventures in an amount per Northstar Subco Class B unit equal to 0.1 times the distribution that otherwise would have been received in respect of such Class B Units. The enhanced distribution shall increase by 0.1 times each fiscal quarter, up to a maximum of 0.5 times (i.e. 150%) the distribution amount otherwise payable per Northstar Subco Class B Unit. The enhanced distribution will be non-cumulative and payable monthly. The enhanced distribution may only be paid to Ventures in respect of a quarter during which the Company has paid dividends on the common shares in an average amount equal to the greater of \$0.10 per common share per month and the monthly amount paid in the month preceding the start of such month.

Other liabilities, non-controlling interest of \$3.4 million at December 31, 2008 and \$28.2 million at December 31, 2007 represent fair value pursuant to GAAP, using the discounted cash flow method and a discount rate of 25%, of the Subco units held by Ventures. This carrying value may not represent the purchase price that would be paid by Northstar Subco, pursuant to the negotiation right contained in the amended and restated limited liability company agreement of Northstar Subco. If the discount rate used was changed, this would have an impact on income (loss) for the year. If the discount rate used was increased by 5%, the income for the year would increase by approximately \$0.9 million. If the discount rate used was decreased by 5%, the income for the year would decrease by approximately \$2.0 million.

The \$24.8 million other income change in the fair value of other liabilities, non-controlling interest for the year ended December 31, 2008 and the \$10.2 million other expense from the inception of operations on May 17, 2007 to December 31, 2007 was based on an external appraisal incorporating the discounted cash flow method and represents the change in fair value of the Northstar Subco Class B Units held by Ventures. This item is recorded as income or expense of the Company under Canadian GAAP as a result of the negotiation right held by Ventures that is described above.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 13. Non-Controlling Interests

Non-controlling interests at December 31, 2008 represents a 30% interest in the Palladium Partnership and a 40% interest in the Kirby Partnership. Non-controlling interests also includes the Northstar Acquisitions Class B Units held by Ventures. Non-controlling interests for the year ended December 31, 2008 was \$6.5 million and \$0.4 million for the physician limited partners and Ventures, respectively. Non-controlling interests from the inception of operations on May 17, 2007 to December 31, 2007 was \$7.3 million and \$0.3 million for the physician limited partners and Ventures, respectively.

### Note 14. Common Shares

On March 16, 2007, the Company was incorporated with an authorized share structure providing for an unlimited number of common shares.

On May 17, 2007, the Company issued 12,087,698 common shares for net proceeds of \$120,866 as part of its initial public offering. On June 5, 2007, the over-allotment option in respect of the offering was exercised resulting in the issuance of 1,813,154 additional common shares for net proceeds of \$18,852.

As of December 31, 2008, the number of shares that are anti-dilutive are 34,426.

### Note 15. Lease Obligations

We lease 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. We recorded rent expense under operating leases of \$1.0 million for the year ended December 31, 2008 and \$0.6 million from the inception of operations on May 17, 2007 to December 31, 2007.

The following table summarizes our future minimum payments under existing operating leases:

<b>Year</b>	<b>Amount</b>
2009 .....	\$ 854
2010.....	867
2011.....	882
2012.....	880
2013.....	675
Thereafter .....	28
Total .....	<u>\$ 4,186</u>

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### **Note 16. Employee Retirement Savings Plan and Benefits**

#### *401 (k) Savings Plan*

The Company has adopted a 401(k) savings plan for its employees. The plan covers substantially all employees. Under the terms of the plan, employees may contribute up to a maximum of 15%, subject to Internal Revenue Code limitations ("IRC"), of their salaries to the plan plus any catch-up contributions permitted under the IRC. The Company may match employee contributions up to 4% of the amount contributed by the employee. The Company's matching contribution was \$91 for the year ended December 31, 2008 and \$33 from the inception of operations on May 17, 2007 to December 31, 2007.

### **Note 17. Share Unit Plans**

#### *Restricted Share Unit Plan*

In February 2008, and as subsequently amended in April and June 2008, the Board approved the adoption of an RSU Plan for employees. RSU's may be granted to employees of Northstar Acquisitions at the sole discretion of the Board.

Subject to the Board's ability to accelerate the vesting of the RSUs if it determines circumstances so warrant, each RSU will vest in full on the third anniversary of the date of grant; provided that if there is a change of control of the Company prior to the vesting date of the RSUs and a participant is terminated (or resigns for good reason) within six months following such change of control, a pro rata portion of their unvested RSUs will vest up to the date of the change of control.

Upon vesting of his or her RSUs, a participant will be entitled to receive on the vesting date, at the discretion of the Board either: (a) a lump sum cash payment equal to the number of RSUs to be redeemed multiplied by a calculation of the fair market value of a common share (determined by reference to the five-day weighted average closing price of the common shares on the Toronto Stock Exchange) on the redemption date, net of any applicable deductions and withholdings; or (b) that number of common shares equal to the number of RSUs credited to the participant's RSU account, such common shares to be issued from treasury of the Company. Unlike options, RSUs do not require the payment of any monetary consideration to Company.

Whenever cash dividends are paid on the Company's common shares, dividend equivalents in the form of additional RSUs will be credited to each Participant and will become part of his or her award under the RSU Plan. The RSUs representing dividend equivalents will vest and be paid at the same time and in the same manner as the RSUs to which the dividend equivalents pertain.

In the event of a Participant's voluntary termination of employment, voluntary or by cause, with the Company prior to any vesting date, the Participant's rights to any unvested RSUs will be immediately and irrevocably forfeited.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 17. Share Unit Plans (continued)

If the Participant's employment with the Company terminates on account of death or disability or is terminated by the Company without cause prior to any vesting date, the Participant will become vested in a prorated portion of his or her unvested RSUs, based on the number of months that have elapsed in the then current vesting period as of the date of termination. As of December 31, 2008, two RSU grants totalling 40,000 have been granted and we recorded an expense of \$79 for the year ended December 31, 2008.

#### *Deferred Share Unit Plan*

In February 2008, and as subsequently amended in June 2008, the Company adopted the DSU Plan for independent members of the Board of Directors. Each Director becomes a participant effective as of the date they are first appointed or elected as a Director, provided that they are not an employee of the Company at such time. In addition to allocated DSUs, each Board of Director may receive any or all of their retainer fees in DSUs under the plan. DSUs vest immediately, but can be redeemed only when a director no longer serves on the Board.

A participant will be permitted to redeem his or her vested DSUs upon ceasing to be a director of the Company. Upon redemption of DSUs, a participant will be entitled to receive on the vesting date, at the discretion of the Board either: (a) a lump sum cash payment equal to the number of DSUs to be redeemed multiplied by a calculation of the fair market value of a common share (determined by reference to the five-day weighted average closing price of the common shares on the Toronto Stock Exchange) on the redemption date, net of any applicable deductions and withholdings; or (b) that number of common shares equal to the number of DSUs credited to the participant's DSU account, such common shares to be issued from treasury of the Company.

A participant may elect to receive any such payment in either Canadian dollars or U.S. dollars. If a Participant elects to receive such payment in U.S. dollars (or if such Participant fails to make an election), the value of such participant's DSU account, net of applicable withholdings, shall be converted into U.S. dollars using the noon buying rate on the effective date such participant ceased to be a Director, as published by the Bank of Canada on its website.

The number of DSUs to be credited to a participant's DSU account related to the payment of fees will be calculated by dividing the Canadian dollar equivalent of the US dollar amount of the elected portion of the fees payable to the participant on a payment date by the weighted average closing price of the common shares during the five trading day period ending on the day prior to payment date. Whenever cash dividends are paid on the Company's common shares, additional DSUs will be credited to the participant's DSUs account.

On February 1, 2008, the Company granted 2,000 DSUs to each of its then three independent members of the Board of Directors. On June 1, 2008, the Company granted 1,000 DSUs to each of two new independent directors. On September 3, 2008, the Company granted an additional 10,000 DSU's to one of its independent directors and recorded expense of \$149 for the year ended December 31, 2008.

# NORTHSTAR HEALTHCARE INC.

## Notes to Consolidated Financial Statements

(in thousands of U.S. dollars, unless otherwise indicated)

For the year ended December 31, 2008 and from the inception of operations on  
May 17, 2007 to December 31, 2007

### Note 17. Share Unit Plans (continued)

#### *Share Unit Plan Amendment*

Effective June 5, 2008, the Company amended both RSU and DSU plans to include settlement options in cash or common shares at the discretion of the Board. Previously the DSU grants of 6,000 units were required to be settled in cash, and were accounted for as liabilities and marked-to-market at each reporting date with changes in the market value being charged to operations. As a result of the amendment, the Company reclassified \$72 previously recorded in accrued liabilities to contributed surplus during the three months ended June 30, 2008.

<u>Contribution Surplus</u>	<u>Number of Units Outstanding</u>	<u>Number of Units Vested</u>	<u>December 31, 2008</u>
DSU Plan .....	-	29,316	\$ 148,715
RSU Plan .....	46,124	-	\$ 78,979
Total .....	<u>46,124</u>	<u>29,316</u>	<u>\$ 227,694</u>

### Note 18. Business Segment Information

We operate in one reportable business segment and one geographic location.