

Consolidated Financial Statements of



NORTHSTAR HEALTHCARE

NORTHSTAR HEALTHCARE INC.

For the Three and Nine Months ended September 30, 2009

(Unaudited)

Northstar Healthcare Inc.
Consolidated Financial Statements
September 30, 2009

Contents

Unaudited Interim Consolidated Financial Statements

Unaudited Interim Consolidated Balance Sheets.....	1
Unaudited Interim Consolidated Statements of Operations and Comprehensive Income	2
Unaudited Interim Consolidated Statements of Deficit	3
Unaudited Interim Consolidated Statements of Cash Flows	4
Notes to Unaudited Interim Consolidated Financial Statements	5 -26

NORTHSTAR HEALTHCARE INC.
Interim Consolidated Balance Sheets
(in thousands of U.S. dollars)

	September 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,381	\$ 3,733
Accounts receivable.....	3,451	8,366
Medical supplies	512	575
Income tax recoverable.....	888	-
Prepaid expenses and other current assets	1,273	1,258
	<u>11,505</u>	<u>13,932</u>
Long term		
Property and equipment (Note 5).....	3,787	4,658
Intangible assets (Note 7).....	1,500	1,658
Goodwill (Note 8).....	15,300	15,300
Other assets	32	35
	<u>20,619</u>	<u>21,651</u>
Total assets	<u>\$ 32,124</u>	<u>\$ 35,583</u>
LIABILITIES		
Current liabilities:		
Accounts payable.....	\$ 719	\$ 1,185
Accrued liabilities and other current liabilities	2,009	1,395
Dividends payable.....	-	659
Income tax payable	-	410
Current portion of obligations under capital lease (Note 9).....	18	-
	<u>2,746</u>	<u>3,649</u>
Long term liabilities:		
Accrued liabilities.....	1,984	1,718
Foreign currency exchange contracts (Note 6).....	-	4,750
Other liabilities, non-controlling interest (Note 12)	3,400	3,400
Obligations under capital lease (Note 9)	10	-
	<u>5,394</u>	<u>9,868</u>
Total liabilities	<u>8,140</u>	<u>13,517</u>
Non-controlling interests (Note 13).....	<u>5,637</u>	<u>7,072</u>
Shareholders' equity		
Share capital (Note 14).....	139,718	139,718
Contributed surplus (Note 17)	697	228
Deficit	(122,068)	(124,952)
	<u>18,347</u>	<u>14,994</u>
Total shareholders' equity	<u>18,347</u>	<u>14,994</u>
Total liabilities and shareholders' equity	<u>\$ 32,124</u>	<u>\$ 35,583</u>

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

NORTHSTAR HEALTHCARE INC.

Interim Consolidated Statements of Operations and Comprehensive Income (in thousands of U.S. dollars, except per share amounts) (Unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Net patient service revenue (Note 18)	\$ 6,843	\$ 9,364	\$ 18,999	\$ 31,243
Operating expenses				
Salaries and benefits	1,571	1,757	5,120	4,951
Drugs and supplies	810	913	2,459	2,724
General and administrative	2,413	1,938	8,260	5,648
Bad debt expense	264	-	814	-
Depreciation and amortization	303	446	1,114	1,333
	<u>5,361</u>	<u>5,054</u>	<u>17,767</u>	<u>14,656</u>
Income from operations	1,482	4,310	1,232	16,587
Other expense (income)				
Distributions, other liabilities, non-controlling interest (Note 12)	133	338	278	1,199
Withholding taxes	-	305	-	996
Change in fair value, other liabilities, non-controlling interest (Note 12)	-	(18,200)	-	(19,000)
(Gain) loss on foreign currency	(2,654)	2,379	(3,892)	3,624
Goodwill and intangible impairment	-	78,941	-	78,941
State franchise tax	49	68	43	211
Other income	(3)	(17)	(11)	(64)
	<u>(2,475)</u>	<u>63,814</u>	<u>(3,582)</u>	<u>65,907</u>
Income (loss) before income taxes and non-controlling interests	3,957	(59,504)	4,814	(49,320)
Income tax expense (recovery) (Note 11)				
Current	-	702	(685)	373
Future	-	(28,588)	-	(27,605)
	<u>-</u>	<u>(27,886)</u>	<u>(685)</u>	<u>(27,232)</u>
Non-controlling interests (Note 13)	1,089	1,753	2,615	6,291
Net income (loss) and comprehensive income (loss)	\$ 2,868	\$ (33,371)	\$ 2,884	\$ (28,379)
Net income (loss) per common share (basic) (Note 14)	\$ 0.21	\$ (2.40)	\$ 0.21	\$ (2.04)
Net income (loss) per common share (fully diluted) (Note 14)	\$ 0.19	\$ (2.40)	\$ 0.20	\$ (2.04)
Weighted average shares outstanding (basic) (Note 14)	13,900,852	13,900,852	13,900,852	13,900,852
Weighted average shares outstanding (fully diluted) (Note 14)	15,197,500	13,952,347	14,522,960	13,922,625

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)

(Unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Deficit, beginning of period	\$ (124,936)	\$ (10,360)	\$ (124,952)	\$ (7,051)
Net income (loss)	2,868	(33,371)	2,884	(28,379)
Dividends	-	(3,424)	-	(11,725)
Deficit, end of period	<u>\$ (122,068)</u>	<u>\$ (47,155)</u>	<u>\$ (122,068)</u>	<u>\$ (47,155)</u>

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

NORTHSTAR HEALTHCARE INC.

Consolidated Statements of Cash Flows

(in thousands of U.S. dollars)

(Unaudited)

CASH FLOWS FROM OPERATING ACTIVITIES:	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Net income (loss).....	\$ 2,868	\$ (33,371)	\$ 2,884	\$ (28,379)
Adjustments to reconcile net income to net cash provided by operating activities:				
Equity based compensation expense.....	133	91	469	182
Depreciation and amortization.....	303	446	1,114	1,333
Intangible asset and goodwill impairment	-	78,941	-	78,941
Future income tax expense	-	(28,588)	-	(27,605)
(Gain) loss on foreign currency exchange contracts	(2,728)	2,572	(4,455)	4,513
Non-controlling interests	1,089	1,753	2,615	6,291
Change in fair value of other liabilities, non- controlling interest.....	-	(18,200)	-	(19,000)
Changes in operating assets and liabilities	505	1,557	4,082	2,027
Cash flows provided by operating activities	<u>2,170</u>	<u>5,201</u>	<u>6,709</u>	<u>18,303</u>
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of property and equipment	(14)	(71)	(53)	(312)
Cash flows used in investing activities	<u>(14)</u>	<u>(71)</u>	<u>(53)</u>	<u>(312)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:				
Distributions to non-controlling interests	(1,163)	(2,287)	(4,050)	(7,632)
Dividends paid.....	-	(3,830)	(740)	(11,490)
Realized foreign exchange loss (gain) on dividends paid.....	-	(198)	81	(876)
Proceeds (repayments) on sale of foreign currency exchange contracts.....	(295)	711	(295)	711
Principal repayments	(4)	-	(4)	-
Cash flows used in financing activities	<u>(1,462)</u>	<u>(5,604)</u>	<u>(5,008)</u>	<u>(19,287)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS.....	694	(474)	1,648	(1,296)
CASH AND CASH EQUIVALENTS, beginning of period	4,687	4,161	3,733	4,983
CASH AND CASH EQUIVALENTS, end of period..	<u>\$ 5,381</u>	<u>\$ 3,687</u>	<u>\$ 5,381</u>	<u>\$ 3,687</u>
Supplemental cash flow information				
Cash paid for income taxes.....	\$ -	\$ 345	\$ 665	\$ 2,079

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 three months and nine months ended September 30, 2009

(Unaudited)

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 on Houston and other metropolitan areas in Texas. NHC used the net proceeds of an 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 prior to July 8, 2009, two pain management clinics in Houston (Note 20).

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

In 2008, the Company paid cash dividends to common shareholders in Canadian dollars, but the Company’s revenues and cash flows are generated in the United States. Therefore we were subject to foreign exchange exposure. We used foreign currency forward contracts to manage the foreign currency fluctuations related to the payment of cash dividends to common shareholders. In January 2009, the Company suspended its monthly dividends. In September 2009, the Company sold its position in the foreign currency forward contracts.

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 three months and nine months ended September 30, 2009
(Unaudited)

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. Revenue and expenses denominated in foreign currencies are translated into Canadian dollars at the average foreign currency exchange rate for the period. Foreign exchange gains and losses on other transactions are recorded in income in the year in which they occur.

In 2008, dividend distributions of the Company were announced monthly, with the date of record generally falling on the last day of the calendar month. At the date of record, the Company recorded 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 was 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. or 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 three and nine months ended September 30, 2009.

(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. Property under capital leases and the related obligation for future lease payments are initially recorded at an amount equal to the lesser of fair value of the property or equipment and the present value of those lease payments. 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 three months and nine months ended September 30, 2009
(Unaudited)

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, based primarily on discounted cash flows.

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, 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.

As a result of a preliminary evaluation of goodwill and indefinite life intangibles impairment during the three months ended September 30, 2008, the Company determined that the carrying value of its goodwill and intangibles related to the acquisition of the Northstar ASCs on May 17, 2007, exceeded fair value. As a result, the Company recorded an impairment charge of \$78.9 million for the three and nine months ended September 30, 2008.

(i) Intangible Assets

Intangible assets include the value of non-compete agreements and 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 three months and nine months ended September 30, 2009
(Unaudited)

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 net realizable 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.

Revenue is recognized upon the performance of the patient service and when ultimate collection is measurable and reasonably assured.

(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. 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 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 provided management services to River Oaks Pain Management until July 8, 2009 (Note 20) in exchange for a management fee of 10% of collected revenues.

(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 three months and nine months ended September 30, 2009
(Unaudited)

Note 1. Significant Accounting Policies and Practices (continued)

(n) Net Income / Loss Per Common Share

We calculate net income/loss per common share by dividing net income/loss available for common shareholders by the weighted average number of common shares outstanding during the period. Fully diluted income/loss per share is computed using the weighted average number of common and potential common shares outstanding during the year. Potential common shares includes those that may be issued upon redemption of units granted under the Company's Deferred Share Unit Plan and Restricted Share Unit Plan (Note 14).

(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 independent 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 DSUs 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 RSUs 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

Recent accounting pronouncements that have been issued but are not yet effective, and have a potential implication for the Company are as follows:

- (i) 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.
- (ii) 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.

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 1. Significant Accounting Policies and Practices (continued)

- (iii) Section 1601, Consolidated financial statements. The new section 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.
- (iv) 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.
- (v) Section 1506, Accounting changes. This section has been amended to exclude from its scope changes in accounting policies upon the complete replacement of an entity's primary basis of accounting. The amendment applies to interim and annual financial statements relating to fiscal years beginning on or after July 1, 2009. The Company is currently evaluating the implications of this new standard.
- (vi) EIC 173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. In January 2009, the Emerging Issues Committee of the CICA ("EIC") issued guidance on the implications of credit risk in determining fair value of an entity's financial assets and financial liabilities. The guidance clarifies that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments, for presentation and disclosure purposes. The conclusions of the EIC were effective from the date of issuance. The Company is currently evaluating the implications of this new standard.
- (vii) Section 3855, Financial instruments – recognition and measurement. This section has been amended to clarify the application of the effective interest method after a debt instrument has been impaired. This amendment is effective for fiscal years beginning on or after July 1, 2009. This section has also been amended to clarify when an embedded prepayment option is separated from its host debt instrument for accounting purposes. This amendment applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The third amendment provides guidance concerning the assessment of embedded derivatives upon reclassification of a financial asset out of the held for trading category. This amendment was made in August 2009 with prospective application. The Company is currently evaluating the implications of this new standard.
- (viii) Section 3862, Financial instruments – disclosures. In June 2009, the AcSB amended certain requirements related to financial instrument disclosure in response to amendments issued by the International Accounting Standards Board. The new disclosure standards require disclosure of fair values based on a fair value hierarchy as well as enhanced discussion and quantitative disclosure related to liquidity risk. The amended disclosure requirements are effective for annual financial statements relating to fiscal years ending after September 30, 2009. Earlier adoption is permitted. To provide relief for preparers, and consistent with IFRS, the AcSB decided that an entity need not provide comparative information for the disclosures required by the amendments in the first year of application. The Company is currently evaluating the implications of this new standard.

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 2. Adoption of New Accounting Standards and Developments

- (a) Effective January 1, 2009, the Company adopted Section 3064 Goodwill and Intangible Assets. This section replaces Handbook Section 3062 Goodwill and Other Intangible Assets and Handbook Section 3450 Research and Development Costs. It 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.
- (b) 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. (Note 4).
- (c) 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 3).
- (d) 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).
- (e) 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.

Note 3. 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 which 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. As of September 30, 2009, the Company had shareholders' equity of \$18.3 million, non-controlling interests of \$5.6 million 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.

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 3. Capital Disclosures (continued)

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 three and nine months ended September 30, 2009.

Note 4. 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 current 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 (Note 12).

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.

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 4. Financial Instruments (continued)

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 receivable 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 are reported at estimated collectible amounts which are based on management's evaluation of historical payment rates, payor mix and current economic conditions. A 5% change in the estimated collectible rates would result in a decrease/increase in pre-tax profit and net assets of \$0.3 million for the three months ended and \$0.9 million for the nine months ended September 30, 2009. A 5% change in the estimated collectible rates would result in a decrease/increase in pre-tax profit and net assets of \$0.5 million for the three months ended and \$1.5 million for the nine months ended September 30, 2008.

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.

Interest rate risk

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

Foreign exchange risk

Foreign exchange risk arises because the Company's revenues are generated in the United States but certain expenses are incurred in Canadian dollars.

The Company had 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 would arise from the payment of dividends on its common shares. The Company recognized gains or losses from any differences between the Canadian to US dollar foreign exchange spot rate and the exchange rate under the Company's currency instruments. During the three months ended September 30, 2009, the Company sold its position in these contracts and recognized a loss of \$0.3 million.

The Company is also exposed to currency risk on purchases made from vendors based in Canada. The Company had trade payables of \$0.1 million denominated in Canadian dollars as of September 30, 2009 and \$0.2 million as of December 31, 2008.

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 4. Financial Instruments (continued)

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. The liquidity risk of the Company and its subsidiaries is managed centrally by the Company's finance function. As a result of certain claims made by the Company and its subsidiaries (Note 20), there is a significant amount of uncertainty regarding the Company's liquidity needs in 2010 and beyond. The Company may be required to expend significant amounts and devote considerable management time to the pursuit of these claims. It is not possible to accurately predict the amount of expenses that will be incurred or the resolution of these matters. If the actual cost of the process exceeds management's estimates, the Company may not have sufficient cash to fund its working capital requirements during the next twelve months.

Note 5. Property and Equipment

September 30, 2009			
(Unaudited)			
Item	Cost	Accumulated Depreciation	Net Book Value
Telephone equipment	\$ 27	\$ 16	\$ 11
Computer hardware	228	116	112
Computer software	119	92	27
Furniture and office equipment	255	114	141
Medical equipment	3,597	1,968	1,629
Leasehold improvements	2,687	820	1,867
Totals	\$ 6,913	\$ 3,126	\$ 3,787

December 31, 2008			
Item	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

The depreciation expense charged to operations was \$0.3 million and \$1.0 million for the three and nine months ended September 30, 2009, respectively. The depreciation expense charged to operations was \$0.3 million and \$1.0 million for the three and nine months ended September 30, 2008, respectively.

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 6. Foreign Currency Contracts, Reporting Currency and Foreign Currency Translation

The Company had initially 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 arose from the payment of dividends on its common shares. During the three months ended September 30, 2009, the Company sold its position in these contracts and recognized a loss of \$0.3 million.

Note 7. 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.

As a result of the unfavourable operating conditions, including the aforementioned 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 consist of the following:

September 30, 2009				
(Unaudited)				
Intangible assets	Cost	Accumulated Amortization	Impairment Write-Down	Net Book Value
Medicare licenses	\$ 8,498	\$ -	\$ 6,998	\$ 1,500
Non-Compete agreements	841	841	-	-
Totals.....	\$ 9,339	\$ 841	\$ 6,998	\$ 1,500

December 31, 2008				
Intangible assets	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

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 7. Intangible Assets (continued)

Intangible assets represent the fair value of the assets that we obtained when we acquired our interests in the Northstar Partnerships. Intangible assets include the value of Medicare licenses and non-compete agreements. Medicare licenses are an indefinite life intangible asset, thus not amortizable. The non-compete agreements are amortized over their estimated useful life of two years. Amortization for the period was zero and \$0.2 million for the three and nine months ended September 30, 2009, respectively, and \$0.1 million and \$0.3 million for the three and nine months ended September 30, 2008, respectively.

Note 8. 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.

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:

Goodwill	September 30, 2009 (Unaudited)	December 31, 2008
Opening balance	\$ 15,300	\$ 139,443
Goodwill impairment.....	-	(124,143)
Net carrying value	<u>\$ 15,300</u>	<u>\$ 15,300</u>

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 9. Obligations Under Capital Lease

	September 30, 2009 (Unaudited)	December 31, 2008
Obligation under capital lease – 7.5%, due March 1, 2011, repayable \$1,660 principal and interest monthly	\$ 28	\$
Current portion	(18)	-
	\$ 10	\$

Obligations under capital lease are secured by the medical equipment (Note 5). Included in general and administrative expense is interest expense of approximately \$1 for the three and nine months ended September 30, 2009.

The future minimum lease payments for the next three years at September 30, 2009 are:

Year	Amount
2009 (remaining three months)	\$ 5
2010	20
2011	5
	30
Less imputed interest	(2)
	\$ 28

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 13). In addition, Donald Kramer, M.D., who resigned as a director of the Company effective February 6, 2009, owns approximately 18% 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 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 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

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 10. Related Parties (continued)

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 incurred 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 also provided cash collateral of \$5.0 million as required to support the Company's performance under foreign currency contracts. 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. During the three months ended September 30, 2009, the Company sold its position in the foreign currency contracts and authorized the release of the cash collateral to Ventures.

Included in accrued liabilities as of September 30, 2009 is \$2.0 million related to deferred Northstar Subco monthly distributions to Ventures, compared to \$1.7 million as of December 31, 2008. 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 2008 to September 2009 was less than 110% of the initial full monthly dividends; accordingly, the payment of \$2.0 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, until July 8, 2009 provided management services to 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. On July 8, 2009, River Oaks Pain Management ceased operations. Dr. Kramer owns 95% of The Palladium for Surgery – Dallas and 100% of River Oaks Pain Management. The Managed Centers are managed by the Company pursuant to separate management agreements. The management agreements provide 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 \$0.1 million and \$0.3 million for the three and nine months ended September 30, 2009 and 2008, respectively.

The Palladium Partnership had a service agreement with Palladium Anaesthesia, P.A., which is controlled by Dr. Kramer, to provide anaesthesiology services for cases performed at the Palladium Partnership. On July 22, 2009, a sixty-day termination notice was provided by the Palladium Partnership to terminate the agreement. Subsequent to termination, the Palladium Partnership engaged with another anaesthesiology group to ensure continuity of its patient care.

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

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

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 Comprehensive Income 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 amounts treated as interest expense for United States income tax purposes on the obligations contained in the Sale and Repurchase Agreement dated May 17, 2007 (the "Repurchase Agreement") between the Company, Northstar Acquisitions and Northstar Healthcare Holdings Inc. ("Northstar Holdco"). The obligations of the Company contained in the Repurchase Agreement historically resulted in an annual interest expense of 11.1% that was eliminated in consolidation. There was no interest expense for the three and nine months ended September 30, 2009, respectively. Interest expense was \$1.6 million and \$5.4 million for the three and nine months ended September 30, 2008, respectively. As noted above, the Company suspended its common share dividends after January 15, 2009. Following the suspension of the dividend, the parties to the Repurchase Agreement entered into an agreement dated March 5, 2009 (the "Forbearance Agreement") pursuant to which, among other things, (i) Northstar Holdco acknowledged that it was in breach of certain of the financial covenants (the "Existing Event of Default") contained in the Repurchase Agreement; (ii) the Company agreed, based on certain terms and conditions, to forbear from taking any action in connection with the Existing Event of Default under the Repurchase Agreement on a month-to-month basis; and (iii) the parties agreed to amend the Repurchase Agreement such that, in the event Northstar Holdco repurchases the Acquisitions Class A Units under the Repurchase Agreement, the Company should realize an internal rate of return of 11.1% per annum on the initial purchase price of the Acquisitions Class A Units plus, if applicable, an additional internal rate of return of 2.0% per annum during each fiscal quarter following the date of the Forbearance Agreement (including, for clarity, the first, second and third fiscal quarters of 2009) for which the Existing Event of Default remains outstanding.

	Three Months Ended September 30, 2009 (Unaudited)	Three Months Ended September 30, 2008 (Unaudited)	Nine Months Ended September 30, 2009 (Unaudited)	Nine Months Ended September 30, 2008 (Unaudited)
Income (loss) before income taxes and non-controlling interests	3,957	(59,504)	4,814	(49,320)
U.S. federal income tax rate	35%	35%	35%	35%
Expected U.S. federal income tax expense	1,385	(20,826)	1,685	(17,262)
Permanent differences				
Intercompany note interest expense...	(222)	(555)	(537)	(1,883)
Change in fair value of non-controlling interest.....	(347)	(6,370)	(801)	(6,650)
Operating loss carry-forward not recorded.....	372	350	1,511	350
Non-controlling interest.....	-	(613)	-	(2,202)
Distribution, other liabilities non-controlling interest.....	47	-	98	-
Release of valuation allowance	(1,257)	-	(2,708)	-
Other	22	128	67	415
Total income taxes.....	<u>\$ -</u>	<u>\$ (27,886)</u>	<u>\$ (685)</u>	<u>\$ (27,232)</u>

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 11. Income Taxes (continued)

(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.

	September 30, 2009 (Unaudited)	December 31, 2008
Future income tax asset:		
Gain on foreign currency.....	\$ -	\$ 1,663
Goodwill.....	37,020	38,927
Intangibles.....	2,226	2,334
U.S. valuation allowance.....	(40,951)	(42,924)
Interest carry-forward.....	1,705	1,153
Non-capital losses.....	7,256	1,881
Share issuance costs.....	1,726	1,813
Canadian valuation allowance.....	(8,982)	(4,847)
Net future income tax asset.....	\$ -	\$ -

The Company has estimated non-capital losses of \$2.3 million, \$14.4 million, and \$4.4 million that expire in 2027, 2028, and 2029, respectively. In addition, the Company has an estimated \$4.8 million in interest carry-forwards which have no expiration date.

Note 12. Other Liabilities, Non-Controlling Interest

Ventures has the right exercisable at any time (but not more frequently than once in any six-month period) to request in writing that Northstar Healthcare Subco, L.L.C. (“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

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 12. Other Liabilities, Non-Controlling Interest (continued)

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 September 30, 2009 and December 31, 2008 represent fair value pursuant to Canadian GAAP, using the discounted cash flow method and a discount rate of 25%, of the Northstar 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 period would decrease by approximately \$2.0 million.

Note 13. Non-Controlling Interests

Non-controlling interests at September 30, 2009 represents a 30% interest in the Palladium Partnership and a 40% interest in the Kirby Partnership. Non-controlling interests also includes the Acquisitions Class B Units held by Ventures. Non-controlling interests for the three and nine months ended September 30, 2009 was \$1.0 million and \$0.1 million and \$2.4 million and \$0.2 million for the physician limited partners and Ventures, respectively. Non-controlling interests for the three and nine months ended September 30, 2008 was \$1.7 million and \$0.1 million and \$6.0 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.

During the nine months ended September 30, 2009, the Board granted RSUs to several employees of the Company, of which 287,436 have vested as of September 30, 2009. In accordance with the second amended and restated RSU plan, upon vesting a Participant is entitled to receive at the discretion of the Board either the number of shares equal to the number of RSUs vested or a cash payment equal to the equivalent of the fair value of the RSUs vested. The payment of shares or cash is to be made on the vesting date, but in no event later than 90 days after the vesting date, which is August 26, 2009 (Note 17). As of September 30, 2009, shares have not been issued in respect of the vested RSUs, but are expected to be issued during the fourth quarter of 2009.

There were no shares that were anti-dilutive for the three and nine months ended September 30, 2009. For the three and nine months ended September 30, 2008, the number of shares that are anti-dilutive are 51,495 and 21,773, respectively.

There were no common shares issued during the three and nine months ended September 30, 2008.

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

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 \$0.2 million and \$0.7 million for the three and nine months ended September 30, 2009, respectively, and \$0.3 million and \$0.7 million for the three and nine months ended September 30, 2008, respectively.

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

<u>Year</u>	<u>Amount</u>
2009 (remaining three months)	\$ 209
2010.....	843
2011.....	859
2012.....	856
2013.....	734
Thereafter	98
Total	<u>\$ 3,599</u>

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 employee's salary. The Company's matching contribution was \$43 and \$111 for the three and nine months ended September 30, 2009, respectively, and \$24 and \$66 for the three and nine months ended September 30, 2008.

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. RSUs 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 generally 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

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 17. Share Unit Plans (continued)

common shares to be issued from treasury of the Company. The participant is to receive the benefit on, or as soon as practicable after, the vesting date, but in no event later than 90 days after the vesting date. Unlike options, RSUs do not require the payment of any monetary consideration to the 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 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.

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. On June 2, 2008, the Company awarded 40,000 RSUs to two employees of the Company. On May 15, 2009, 20,000 of these RSUs were forfeited as a result of the Company's Chief Operating Officer leaving the Company. On May 28, 2009, the Company awarded 1,060,419 additional RSUs to employees of the Company.

RSU expense for the period was \$0.1 million and \$0.3 million for the three and nine months ended September 30, 2009, respectively. RSU expense was \$34 and \$44 for the three and nine months ended September 30, 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.

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 17. Share Unit Plans (continued)

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 DSUs to one of its independent directors. On May 28, 2009, the Company granted 33,246 DSUs to each of its five independent members of the Board of Directors.

DSU expense for the period was \$3 and \$100 for the three and nine months ended September 30, 2009, respectively. DSU expense was \$57 and \$137 for the three and nine months ended September 30, 2008, respectively.

Share Unit Plan Amendments

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 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.

September 30, 2009 (Unaudited)

	Number of Units Outstanding	Number of Units Vested	Contributed Surplus
DSU Plan	216,018	216,018	\$ 269
RSU Plan	1,084,920	287,436	\$ 428
Total	1,300,938	503,454	\$ 697

December 31, 2008

	Number of Units Outstanding	Number of Units Vested	Contributed Surplus
DSU Plan	29,316	29,316	\$ 149
RSU Plan	46,124	-	\$ 79
Total	75,440	29,316	\$ 228

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 18. Change in Accounting Estimates

The Northstar ASC's include net patient service revenues reported at the estimated net realizable 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.

In June 2009, after comparing historical payment data to the estimated net patient service revenues primarily reported in 2008, management determined that actual collections as of June 30, 2009 had exceeded 2008 reported revenues (actual collections exceed net patient services revenues recorded). As a result, the Company recorded a \$1.5 million increase to net patient service revenues during the three months ended June 30, 2009. During the three months ended September 30, 2009, the Company recorded an additional \$1.3 million increase to net patient service revenue.

Note 19. Business Segment Information

The Company operates in one reportable business segment and one geographic location and operates only in the United States.

Note 20. Subsequent Events and Litigation Update

In May 2009, Northstar announced that it has made claims against Dr. Kramer, related entities and certain former managers under agreements relating to Northstar's acquisition of its interests in the Palladium Partnership. The Company has given notice of these claims to the escrow agent and has instructed it to not release any of the approximately \$8.3 million currently held in escrow for such parties. In November 2009, the Company settled the claims made against the certain former managers.

Under the applicable agreement, resolution of these claims involves mutual good faith discussion, mediation, followed by binding arbitration in Texas. The Company filed a request for mediation with the American Arbitration Association in July 2009.

Mediation hearings were conducted in September and October 2009. As of November 11, 2009, the Company has not reached a settlement with Dr. Kramer and continues to pursue these claims in order to achieve a resolution.

There can be no assurance that the Company will be successful or that it will recover any material amounts under such claims. The expenses involved in investigating and pursuing such claims could have a material adverse effect on the operations and cash flows of Northstar as a whole.

On July 10, 2009, Palladium for Surgery – Dallas delivered notice to Northstar Acquisitions alleging certain breaches of the management agreement between the two entities. Northstar Acquisitions disputes these allegations. Under the terms of the Palladium – Dallas management agreement, Palladium – Dallas has the right to terminate the contract in the event of a material breach by Northstar Acquisitions of its obligations thereunder which continues for a period of 60 days after notice; provided that if such default is of a nature that it cannot be cured within 60 days, then the agreement shall not terminate provided Northstar Acquisitions shall make and continue to make a bona fide effort to cure any such default. Dr. Kramer owns a 95% interest in Palladium for Surgery – Dallas. In October 2009, Palladium for Surgery

NORTHSTAR HEALTHCARE INC.

Notes to Consolidated Financial Statements

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

For the three months and nine months ended September 30, 2009

(Unaudited)

Note 20. Subsequent Events and Litigation Update (continued)

– Dallas sent a second notice to terminate the management. In November 2009, Northstar Acquisitions replied to the second notice disputing the allegations indicating that there was no breach to the management agreement. Northstar Acquisitions will continue to manage the center through a transition period and expects to transfer management of the center to Dr. Kramer on December 31, 2009 while reserving its legal rights. The revenue from the management fees charged to the Managed Centers for the three and nine months ended September 30, 2009 was \$0.1 million and \$0.3 million, respectively.

On November 4, 2009, the Company announced that the Palladium Partnership had reached a complete resolution to its dispute with one of its largest payors, a major private health insurance provider. As a critical component of the resolution, the parties have signed a Settlement Agreement under which the Palladium Partnership and the payor have agreed to release each other from any past or present claims related to the dispute.

In addition to the Settlement Agreement, the Palladium Partnership entered into a Facility Participation Agreement with the payor. Under this in-network agreement, surgical procedures performed at Palladium-Houston will be reimbursed by the payor at agreed-upon rates. The contract is effective December 1, 2009 for an initial period of three years, extendible annually thereafter.

In finalizing terms of the contract, the Palladium Partnership and the payor have agreed that the payor will adjudicate previously billed claims, which have remained unpaid, excluding claims billed for procedures performed by certain non-partner physicians.