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12-31-06
AR/S

Consolidated Financial Statements
(In U.S. dollars)

# MEDICAL FACILITIES CORPORATION

December 31, 2006 and 2005

KPMG LLP
Chartered Accountants
Suite 3300 Commerce Court West
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Toronto ON M5L 1B2
Canada

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# AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Medical Facilities Corporation as at December 31, 2006 and 2005 and the consolidated statements of income and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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 Corporation as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Toronto, Canada

March 6, 2007

# MEDICAL FACILITIES CORPORATION

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

| | December 31, 2006 | December 31, 2005 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 15,367 | $ 12,443 |
| Accounts receivable | 27,677 | 25,571 |
| Medical supplies | 2,744 | 2,369 |
| Prepaid expenses and other | 1,330 | 1,541 |
| Income taxes recoverable (note 10) | 5,129 | 4,861 |
| | **52,247** | **46,785** |
| Property and equipment (note 4) | 30,931 | 31,912 |
| Restricted cash (note 12) | 4,483 | 4,483 |
| Foreign exchange forward contracts (note 12) | 2,424 | 6,900 |
| Deferred financing costs | 9,006 | 9,515 |
| Intangibles (note 5) | 103,392 | 112,389 |
| Goodwill (note 5) | 56,244 | 56,244 |
| | **$ 258,727** | **$ 268,228** |
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities: | | |
| Accrued interest payable | $ 1,494 | $ 1,483 |
| Dividends payable | 734 | 729 |
| Accounts payable | 3,518 | 4,688 |
| Accrued liabilities | 6,178 | 4,796 |
| Current maturities of long-term debt (note 6) | 1,758 | 1,085 |
| | **13,682** | **12,781** |
| Long-term debt less current maturities (note 6) | 22,811 | 23,813 |
| Future income tax liability (note 10) | 1,837 | 2,602 |
| Subordinated notes payable (note 8) | 141,711 | 142,106 |
| Minority interests | 16,771 | 16,021 |
| Shareholders' equity: | | |
| Share capital (note 8) | 93,648 | 93,700 |
| Deficit | (31,733) | (22,795) |
| | **61,915** | **70,905** |
| Commitments and contingencies (note 13) | | |
| | **$ 258,727** | **$ 268,228** |

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Seymour Temkin

Alan J. Dilworth

# MEDICAL FACILITIES CORPORATION

Consolidated Statements of Income and Deficit
(In thousands of U.S. dollars, except per share amounts)

| | Year Ended December 31, 2006 | Year Ended December 31, 2005 |
|---|---|---|
| **Net patient service revenue** | **$ 148,537** | **$ 121,963** |
| **Expenses:** | | |
| Salaries and benefits | 33,960 | 28,992 |
| Drugs and supplies | 31,399 | 23,501 |
| Other operating expenses | 1,583 | 1,554 |
| General and administrative | 21,494 | 17,300 |
| | **88,436** | **71,347** |
| **Income before the under noted** | **60,101** | **50,616** |
| Depreciation and amortization | 12,894 | 11,380 |
| Other expenses (income): | | |
| Interest expense, net of interest income | 19,343 | 16,739 |
| Amortization of deferred financing costs | 509 | 366 |
| Loss on foreign currency (note 14) | 254 | 1,721 |
| Other expenses (income) | (249) | (247) |
| | **19,857** | **18,579** |
| **Income before income taxes and minority interest** | **27,350** | **20,657** |
| Income taxes (note 10) | (95) | 859 |
| Income before minority interest | 27,445 | 19,798 |
| Minority interests in the income of subsidiaries | 27,427 | 23,301 |
| **Net income (loss) for the period** | **18** | **(3,503)** |
| Deficit, beginning of period | (22,795) | (11,652) |
| Dividends | (8,956) | (7,640) |
| **Deficit, end of period** | **$ (31,733)** | **$ (22,795)** |
| **Basic and diluted income (loss) per share (note 8(b))** | **$ 0.001** | **$ (0.139)** |

See accompanying notes to consolidated financial statements.

# MEDICAL FACILITIES CORPORATION

Consolidated Statements of Cash Flows
(In thousands of U.S. dollars, except per share amounts)

| | Year Ended December 31, 2006 | Year Ended December 31, 2005 |
|---|---|---|
| **Cash provided by (used in):** | | |
| **Operating activities:** | | |
| Income (loss) for the period | $ 18 | $ (3,503) |
| Items not affecting cash: | | |
| Depreciation of property and equipment | 3,897 | 3,671 |
| Amortization of other intangibles | 8,997 | 7,709 |
| Amortization of deferred financing costs | 509 | 366 |
| Minority interest | 27,427 | 23,301 |
| Future tax expense (recovery) (note 10) | (765) | 859 |
| Unrealized loss on foreign currency (note 14) | 4,182 | 4,353 |
| Change in non-cash operating working capital | (2,316) | (1,483) |
| | **41,949** | **35,273** |
| **Financing activities:** | | |
| Proceeds from (repayments of) bank loans | (328) | 276 |
| Distributions to minority interests | (26,677) | (22,664) |
| Purchase of the IPS units under the terms of normal course issuer bid (note 8(c)) | (153) | - |
| Dividends | (8,951) | (7,460) |
| Public offering of IPS units, net of expenses (note 8) | - | 55,305 |
| Deferred financing costs | - | (1,812) |
| Restricted cash posted as collateral for foreign exchange forward contracts | - | (1,383) |
| | **(36,109)** | **22,262** |
| **Investing activities:** | | |
| Business acquisitions, net of cash and cash equivalents of $1,322 | - | (43,640) |
| Purchase of property and equipment, net | (2,916) | (5,674) |
| | **(2,916)** | **(49,314)** |
| Increase in cash and cash equivalents | 2,924 | 8,221 |
| Cash and cash equivalents, beginning of period | 12,443 | 4,222 |
| **Cash and cash equivalents, end of period** | **$ 15,367** | **$ 12,443** |
| Supplemental cash flow information: | | |
| Interest paid | $ 20,042 | $ 15,599 |
| Non-cash transactions: | | |
| Acquisition of additional interest in Black Hills Surgery Center, LLP (note 3(b)) | $ - | $ (4,148) |

See accompanying notes to consolidated financial statements.

Medical Facilities Corporation (the "Corporation") owns indirect controlling interests in four limited liability entities (the "Centers"), each of which owns a specialty hospital. The Centers are located in Sioux Falls, Rapid City and Aberdeen, South Dakota, and Oklahoma City, Oklahoma, United States. As these Centers operate in the same industry and in the same country they are not broken down in segments.

## 1. Significant accounting policies:

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada and include the accounts of the Corporation and all of its subsidiaries. Intercompany transactions and balances have been eliminated. The significant accounting policies are described below:

(a) Functional currency:

The Corporation's consolidated financial statements are reported in U.S. dollars, as the principal operations of its subsidiaries are conducted in U.S. dollars.

The Corporation translates monetary assets and liabilities denominated in non-U.S. currencies, principally its subordinated notes payable and certain of its cash balances, which are denominated in Canadian dollars, at exchange rates in effect at the consolidated balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations were incurred. Revenue and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses, including translation adjustments, are included in income.

(b) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates. Significant estimates not disclosed elsewhere in the accompanying consolidated financial statements mostly relate to net patient service revenue (note 1(d)), accounts receivable (note 1(f)) and goodwill impairment (note 1(h)).

(c) Medical supplies:

Medical supplies are stated at cost, using a first-in, first-out valuation.

**1. Significant accounting policies (continued):**

(d) Net patient service revenue:

Net patient service revenue represents the estimated net realizable amounts from patients, third party payors and others for services rendered. Net patient service revenue also includes estimated retroactive adjustments under reimbursement agreements with third party payors.

Each Center has agreements with third party payors that provide for payments at amounts different from the Center's established rates. Payment arrangements include prospectively determined rates per diagnosis, reimbursed costs, discounted charges and per diem payments. Settlements under reimbursement arrangements are accrued on an estimated basis in the period the services are rendered, and are adjusted in future periods, as final settlements are determined. Differences between the estimated amounts accrued and interim and final settlements are reported in operations in the period of settlement.

(e) Cash and cash equivalents:

The Corporation considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

(f) Accounts receivable:

Accounts receivable are recorded at the time services are rendered. Payment from third party payors are generally received within 60 days of the billing date, and residual amounts due from patients are considered past due 30 days after receiving payment from third party payors. Interest is charged on past due balances; however, such interest is not reflected as income until it is collected from the patients. Accounts receivable are recorded net of allowance for contractual discounts with the third party payor and allowance for uncollectible amounts from the patients:

(i) An allowance for third party payor discounts is maintained at a level management believes is adequate to cover estimated future discounts on accounts receivable balances. The allowance is established using the third party payor contracts effective at period end and based on historical payment rates; and

**1. Significant accounting policies (continued):**

(ii) An allowance for uncollectible patient receivable balances is maintained at a level, which management believes is adequate to absorb probable losses. Management determines the adequacy of the allowance based on historical data, current economic conditions and other pertinent factors for the respective Center. Patient receivables are charged off as uncollectible when all reasonable collection efforts are exhausted.

(g) Property and equipment:

Property and equipment are stated at cost. Depreciation is computed using the straight-line and declining-balance methods over the estimated useful lives of the assets as follows:

| | |
|---|---|
| Building and improvements | 15-39 years |
| Equipment and furniture | 3-7 years |

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

(h) Intangibles and Goodwill:

Goodwill represents the excess of cost over the fair value of net assets acquired. Other intangibles represent the value of the hospital operating licenses, medical charts and records, referral sources and trade names. All other intangibles, except trade names are amortized on a straight-line basis over their respective economic lives. Trade names have an indefinite life and are not amortized, but are reviewed for impairment at least annually. Goodwill is not amortized but is reviewed at least annually for impairment.

(i) Deferred financing costs:

Included in the deferred financing costs are amounts associated with the issuance of the subordinated notes. These amounts are amortized on a straight-line basis over 20 years, the expected term of the debt.

**1. Significant accounting policies (continued):**

(j) Income taxes:

The Corporation uses the asset and liability method of accounting 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 of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the periods in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

(k) Foreign exchange forward contracts:

The Corporation enters into forward foreign exchange contracts to manage the Corporation's exposure to fluctuations in the exchange rate between US and Canadian currencies, which exposure arises from payment of interest and dividends on its Income Participating Securities ("IPS") and payment of certain corporate expenses being made in Canadian dollars. These foreign exchange forward contracts are treated as freestanding derivative financial instruments and are recorded at fair value. Unrealized gains and losses resulting from changes in fair value and realized gains and losses upon settlement of the forward contracts are included in "Loss on foreign currency" in the consolidated statement of income and deficit.

(l) Recent accounting pronouncements:

In January 2003, the CICA issued Handbook Sections 3855, "Financial Instruments – Recognition and Measurement", 1530, "Comprehensive Income", 3251 "Equity" and Section 3865, "Hedges". The new standards will be effective for interim and annual financial statements commencing in 2007. The new standards will require presentation of a separate statement of comprehensive income. Foreign exchange gains and losses on the translation of the financial statements of self-sustaining subsidiaries previously recorded in a separate section of shareholders' equity will be presented in comprehensive income. The Corporation is assessing the impact of these new standards.

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**2. Net patient service revenue and accounts receivable:**

The Centers receive payment for services rendered from federal and state agencies, private insurance carriers, employers, managed care programs and patients. Revenue and receivables from government agencies and certain private insurance carriers are significant to the Centers' operations; however, management does not believe that there are any significant credit risks associated with these government agencies and private insurance carriers.

Blue Cross Blue Shield and Medicare accounted for 28.7% and 16.1% of the net patient service revenues in 2006 (2005: 30.1% and 15.6% respectively).

**3. Acquisitions:**

In 2005 the Corporation undertook the following acquisitions:

(a) Oklahoma Spine Hospital, LLC

On June 21, 2005, the Corporation purchased, with a portion of the proceeds from a public offering on the same date, an indirect 51% interest in Oklahoma Spine Hospital, LLC, a limited liability corporation that owns a specialty hospital in Oklahoma City, Oklahoma, for cash consideration of $44,962. Amounts allocated to goodwill and intangibles are deductible for income tax purposes and, accordingly, no future income tax liabilities have been recorded. Also included in the purchase price are costs directly related to the acquisition. The results of Oklahoma Spine Hospital are included from the date of acquisition.

| | | |
|---|---|---|
| Current assets including cash of $1,322 | $ | 13,600 |
| Current liabilities | | (2,915) |
| Note receivable from related party | | 250 |
| Property and equipment | | 2,751 |
| Intangibles | | 30,310 |
| Goodwill | | 10,111 |
| Long-term debt | | (4,999) |
| Minority interests | | (4,146) |
| Cash consideration | $ | 44,962 |

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**3. Acquisitions (continued):**

(b) Step-up acquisition of Black Hills Surgery Center, LLP

On September 1, 2005, pursuant to the terms of the Exchange Agreement between the Corporation and the Centers (see note 8 (d)), the minority owner of Black Hills Surgery Center, LLP exchanged 1.95% of the ownership units in the Center for IPS of the Corporation. Under this transaction, the Corporation issued 418,323 IPS units, which were valued at Cdn$4,915,000 (US$4,150) based on the market value of the IPS units on the date of the transaction. The allocation of the consideration between subordinated notes payable and share capital is presented in note 8. The transaction gave rise to intangible assets (representing hospital licenses, medical charts and records and referral sources) of $2,748 and goodwill of $1,121. Intangible assets are amortized on a straight-line basis over their estimated economic life consistent with the amortization of intangible assets that arose on acquisition of the initial 51% interest in the Center in 2005.

**4. Property and equipment:**

| 2006 | Cost | Accumulated Deprecation | Net Book Value |
|---|---|---|---|
| Land and improvements | $ 2,713 | $ – | $ 2,713 |
| Building and improvements | 24,012 | 3,437 | 20,575 |
| Equipment and furniture | 14,313 | 6,670 | 7,643 |
| | **$ 41,038** | **$ 10,107** | **$ 30,931** |

| 2005 | Cost | Accumulated Deprecation | Net Book Value |
|---|---|---|---|
| Land and improvements | $ 2,706 | $ – | $ 2,706 |
| Building and improvements | 23,081 | 2,058 | 21,023 |
| Equipment and furniture | 12,462 | 4,279 | 8,183 |
| | **$ 38,249** | **$ 6,337** | **$ 31,912** |

Included in the equipment and furniture is certain equipment under a long-term lease agreement as follows:

| | 2006 | 2005 |
|---|---|---|
| Equipment | $ 941 | $ 941 |
| Less accumulated amortization | (795) | (619) |
| | $ 146 | $ 322 |

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

## 5. Intangibles and goodwill:

(a) Intangibles:

| | 2006 | | | 2005 | | | |
|---|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Book Value | Gross Carrying Amount | Accumulated Amortization | Net Book Value | Amortization Period (Years) |
| Hospital operating licenses | $ 571 | $ 312 | $ 259 | $ 571 | $ 198 | $ 373 | 5 |
| Medical charts and records | 5,595 | 2,036 | 3,559 | 5,595 | 1,140 | 4,455 | 5-7 |
| Referral sources | 110,875 | 19,178 | 91,697 | 110,875 | 11,191 | 99,684 | 10-15 |
| Trade names | 7,877 | – | 7,877 | 7,877 | – | 7,877 | None (indefinite life) |
| | **$ 124,918** | **$ 21,526** | **$103,392** | **$124,918** | **$ 12,529** | **$112,389** | |

The Corporation estimates the annual aggregate amortization expense associated with finite life intangibles, without taking into account any future acquisitions, as follows:

| | |
|---|---|
| 2007 | $ 8,997 |
| 2008 | 8,997 |
| 2009 | 8,911 |
| 2010 | 8,706 |
| 2011 | 8,134 |
| Thereafter | 51,771 |
| Total | $ 95,516 |

(b) Goodwill:

Changes in the carrying amount of goodwill for the years ended December 31, 2006 and December 31, 2005 were as follows:

| | |
|---|---|
| Balance as at December 31, 2004 | $ 45,012 |
| Goodwill acquired on the purchase of Oklahoma Spine Hospital, LLC (note 3 (a)) | 10,111 |
| Goodwill acquired on the step-up acquisition of Black Hills Surgery Center, LLC (note 3 (b)) | 1,121 |
| Balance as at December 31, 2005 and December 31, 2006 | $ 56,244 |

The Corporation performed its annual impairment test for intangibles with an indefinite life and goodwill as at December 31, 2006 and determined that there was no impairment.

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**6. Long-term debt:**

| | Authorized $ | December 31, 2006 $ | December 31, 2005 $ |
|---|---|---|---|
| Revolving Credit Facilities | | | |
| Black Hills Surgery Center, LLP | 5,500 | 2,025 | 2,523 |
| Dakota Plains Surgical Center, LLP | 5,000 | 3,232 | 4,205 |
| Sioux Falls Surgical Center, LLP | 6,400 | 2,579 | 6,833 |
| Oklahoma Spine Hospital, LLC | 5,000 | 1,500 | 1,000 |
| | 21,900 | 9,336 | 14,561 |
| Notes Payable | | | |
| Black Hills Surgery Center, LLP | 8,954 | 8,955 | 9,798 |
| Sioux Falls Surgical Center, LLP | 5,972 | 5,972 | - |
| | 14,926 | 14,927 | 9,798 |
| Capital Lease (note 7) | | | |
| Sioux Falls Surgical Center, LLP | | 306 | 539 |
| | | 24,569 | 24,898 |
| Less Current Portion | | 1,758 | 1,085 |
| | | **22,811** | **23,813** |

The credit facilities and note payable for Sioux Falls Surgical Center, LLP and Dakota Plains Surgical Center, LLP bear interest at rates that vary with prime and at December 31, 2006, the effective interest rate was approximately 7.75% (December 31, 2005 - 7.00%). The credit facility for Oklahoma Spine Hospital, LLC bears interest at a rate that varies with LIBOR and at December 31, 2006, the effective interest rate was approximately 7.57% (December 31, 2005 - 8.25%). With respect to the Black Hills Surgery Center, LLP, credit facilities of $2,025 (December 31, 2005 - $2,523) vary with monthly LIBOR (effective interest rate of 7.38% at December 31, 2006 and 6.44% at December 31, 2005) and notes payable of $8,955 are at fixed weighted average interest rate of 5.76% (December 31, 2005 - $9,798 at fixed weighted average interest rate of 5.73%).

The Sioux Falls Surgical Center, LLP credit facilities and note payable mature between 2007 and 2011.The credit facility related to Dakota Plains Surgical Center, LLP is due in full on April 15, 2008. The credit facility related to Oklahoma Spine Hospital, LLC is due in full on May 31, 2010. The Black Hills Surgery Center, LLP credit facilities and notes payable mature between 2007 and 2010.

Each credit facility is secured by a security interest in all property and a mortgage on real property owned by the respective Center. These credit facilities contain certain restrictive covenants.

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**6. Long-term debt (continued):**

The following are the future maturities of long-term debt for the years ending December 31, 2006:

| | |
|---|---|
| 2007 | $ 1,731 |
| 2008 | 6,546 |
| 2009 | 2,560 |
| 2010 | 6,400 |
| 2011 | 7,332 |
| | $ 24,569 |

**7. Capital lease:**

One of the Centers leases certain equipment under a long-term lease agreement, which lease has been recorded as a capitalized lease. Minimum future lease payments for the capital lease are as follows:

| | 2006 | 2005 |
|---|---|---|
| 2006 | $ – | $ 253 |
| 2007 | 253 | 253 |
| 2008 | 63 | 63 |
| Total minimum lease payments | 316 | 569 |
| Less interest | (10) | (30) |
| Present value of minimum lease payments (note 6) | $ 306 | $ 539 |

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

## 8. Subordinated notes payable and capital stock:

Since its inception, the Corporation has made two offerings of IPS. Each IPS represents: (a) Cdn$5.90 aggregate principal amount of 12.5% subordinated notes of the Corporation and (b) one common share of the Corporation. In 2005 the Corporation issued 5,420,000 IPSs in conjunction with the acquisition of Oklahoma Spine Hospital, LLC (See note 3(a)) and 418,323 IPSs for the acquisition of an additional interest in Black Hills Surgery Center, LLC pursuant to the Exchange Agreement (See note 3(b)). Holders of IPSs have the right to separate the IPSs into the Common Shares and Subordinated Notes represented thereby upon the occurrence of a change of control of the Corporation. Separation of the IPSs will occur automatically upon a repurchase, redemption or maturity of the Subordinated Notes. Similarly, any holder of Common Shares and Subordinated Notes may, at any time, combine the applicable number of Common Shares and principal amount of Subordinated Notes to form IPSs.

(a) Subordinated notes payable:

The carrying amounts of subordinated notes were as follows:

| | Cdn$ ('000) | US$ |
|---|---|---|
| Balance as at January 1, 2005 | 130,821 | 108,837 |
| Subordinated notes issued in conjunction with the purchase of Oklahoma Spine Hospital, LLC (note 3 (a)) | 31,978 | 25,632 |
| Subordinated notes issued in conjunction with the step up acquisition of Black Hills Surgery Center, LLP (note 3 (b)) | 2,468 | 2,084 |
| Unrealized foreign currency loss (note 14) | – | 5,553 |
| Balance as at December 31, 2005 | 165,267 | 142,106 |
| Subordinated notes purchased under the terms of the normal course issuer bid in 2006 (note 8(c)) | (118) | (101) |
| Unrealized foreign currency gain | – | (294) |
| Balance as at December 31, 2006 | 165,149 | 141,711 |

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**8. Subordinated notes payable and capital stock (continued):**

The Subordinated Notes mature on March 29, 2014, subject to the Corporation's right to extend their maturity for two additional successive five year terms provided certain conditions are satisfied at such times. On or after March 29, 2009, the Corporation will have the option to redeem the Subordinated Notes in whole or in part at any time, for cash, at a redemption price equal to a premium over the principal amount of the Subordinated Notes, which premium decreases over time.

(b) Share capital and loss per share:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | Shares | $ | Shares | $ |
| Common Shares | | | | |
| Opening balance | 28,011,535 | 93,700 | 22,173,212 | 61,961 |
| Issued for cash | - | - | 5,420,000 | 29,673 |
| Issued on exchange for interest in Black Hills Surgery Center, LLC | - | - | 418,323 | 2,066 |
| Purchased under the terms of normal course issuer bid (note 8(c)) | (20,000) | (52) | | |
| Closing balance | 27,991,535 | 93,648 | 28,011,535 | 93,700 |

The loss per share for the year is calculated on the basis of the weighted average number of shares outstanding for the period of 28,011,371 (2005: 25,193,802).

(c) Normal course issuer bid:

On December 21, 2006, the Corporation received regulatory approval for a normal course issuer bid, under which the Corporation may purchase up to 840,000 of its Income Participating Securities ("IPS units") during the twelve-month period ending December 20, 2007. Through the end of 2006 the Corporation purchased 20,000 IPS for an aggregate consideration of $153.

(d) Exchange agreements:

Concurrent with the acquisition of its interests in the Centers, the Corporation entered into exchange agreements with the holders of the minority interest in the Centers. Pursuant to the terms of these exchange agreements, the minority interest holders in each of the Centers are entitled to exchange up to 14% (12.05% for Black Hills Surgery Center, LLP) of their original partnership interest in the respective Center for IPS units of the Corporation. Such exchanges may only take place quarterly and are based on the exchange formulae stipulated in the exchange agreements and are subject to certain limitations.

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**9. Employee future benefits:**

Benefits programs at each of the Centers include a qualified 401(k) retirement plan, which covers all employees who meet eligibility requirements. Each Center makes matching contributions subject to certain limits. In 2006 contributions made by the Centers to such plans were $792 (in 2005 - $573).

**10. Income taxes:**

The U.S. tax return for the Corporation is prepared on a consolidated basis and includes balances and amounts attributable to both Canadian and U.S. entities. The Canadian income tax return for the Corporation is prepared on a stand-alone basis and includes non-consolidated balances attributable to the Canadian entity only. Income taxes reported in the Consolidated Financial Statements are as follows:

| | 2006 | 2005 |
|---|---|---|
| Components of total income taxes | | |
| U.S. income taxes (recovery) | | |
| Current | 670 | – |
| Future | (765) | 859 |
| Total U.S. income taxes (recovery) | (95) | 859 |
| Canadian income taxes | | |
| Current | – | – |
| Future | – | – |
| Total Canadian income taxes | $ – | $ – |

As the Centers are partnerships, they are required to withhold and deposit with the government tax on the portion of their income allocable to the Corporation at a rate of 35%. The amount of the withholding tax deposited by the Centers is reduced by the estimated provision for the current income taxes as follows:

| | 2006 | 2005 |
|---|---|---|
| Withholding tax deposited | $ 5,799 | $ 4,861 |
| Provision for current income taxes | (670) | – |
| Income taxes recoverable | $ 5,129 | $ 4,861 |

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**10. Provision for income taxes (continued):**

The following is a reconciliation of income taxes, calculated at the Canadian combined federal and provincial income tax rate and the U.S. combined federal and state tax rate, to the income tax benefit (expense) reported in the Consolidated Statements of Income and Deficit:

| | 2006 | % | 2005 | % |
|---|---|---|---|---|
| **U.S. income taxes** | | | | |
| Consolidated pre-tax net income (loss) | $ 77 | 100% | $ (2,644) | 100% |
| Expected tax expense (recovery) at the combined U.S. federal and state rates | 27 | 36.00 | 951 | 36.00 |
| Non-deductible expenses | (34) | (44.36) | (27) | (1.02) |
| Other differences at Center level | - | - | 328 | 12.41 |
| True-up of tax return differences | (15) | (19.62) | (3) | (0.11) |
| Change in valuation allowance | 106 | 138.45 | (2,222) | (84.07) |
| Other | 11 | 14.57 | 114 | 4.31 |
| Income tax benefit (expense) | $ 95 | 125.04 | $ (859) | 32.48 |
| **Canadian income taxes** | | | | |
| Non-consolidated pre-tax loss of Canadian entity | $ (15,945) | 100% | $ (20,813) | 100% |
| Expected tax recovery at the combined Canadian federal and provincial rate | 5,760 | 36.12 | 7,518 | 36.12 |
| Non-deductible foreign exchange loss | (171) | (1.07) | (1,709) | (8.21) |
| Change in valuation allowance | (4,772) | (29.93) | (6,681) | (32.10) |
| Other | (817) | (5.12) | 872 | 4.19 |
| Income tax benefit (expense) | $ – | – | $ – | – |

As of December 31, 2006, the Corporation has the following net operating loss carryforwards for Canadian tax purposes that are scheduled to expire in the following years:

| | |
|---|---|
| 2014 | $ 15,079 |
| 2015 | 17,988 |
| 2026 | 20,910 |
| | $ 53,977 |

Losses related to the Canadian entity may only be used to offset the future income of the Canadian entity for Canadian income tax purposes.

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**10. Provision for income taxes (continued):**

The components of future income tax balances are as follows:

| | 2006 | 2005 |
|---|---|---|
| U.S. income taxes | | |
| Future income tax assets | | |
| Property and equipment | $ 119 | $ 152 |
| Allowance for doubtful accounts | 800 | 715 |
| Accrued liabilities | 206 | 368 |
| Net unrealized foreign exchange loss | 5,043 | 3,537 |
| Net operating loss carryforwards | - | 67 |
| Future income tax liabilities | | |
| Prepaid expenses and other | (83) | (61) |
| Intangibles and goodwill | (2,006) | (1,359) |
| Net future income tax asset | 4,079 | 3,419 |
| Less valuation allowance | (5,916) | (6,021) |
| Net future income tax liability | $ (1,837) | $ (2,602) |
| | | |
| Canadian income taxes | | |
| Future income tax assets | | |
| Net operating loss carryforwards | $ 18,352 | $ 12,256 |
| Share issuance costs | 1,524 | 2,188 |
| Future income tax liability | | |
| Deferred financing costs | (1,396) | (736) |
| Net future income tax asset | 18,480 | 13,708 |
| Less valuation allowance | (18,480) | (13,708) |
| Net future income tax asset | $ - | $ - |

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

## 11. Related party transactions:

The Corporation and the Centers routinely enter into transactions with certain related parties. Such transactions, which are described below, are in the normal course of operations and are at the exchange amounts agreed upon by the parties involved.

(a) Management services and other contracts:

| | 2006 $ | 2005[1] $ |
|---|---|---|
| Management services acquired by Dakota Plains Surgical Center, LLP from Sioux Falls Surgical Physicians, LLP ("Surgical Physicians")[2] | 223 | 223 |
| Laundry services obtained by Sioux Falls Surgical Center, LLP from Center Inn[3] | 100 | 96 |
| Office and management services acquired by Oklahoma Spine Hospital, LLC from Integrated Medical Delivery, LLC("IMD")[4] | 2,294 | 1,368 |
| Costs incurred by the Corporation for aircraft chartered from SC Meridian, LLC[5] | 31 | 238 |
| Reimbursement to Sioux Falls Surgical Center, LLP for services provided under a contract to or on behalf of Surgical Physicians and Surgical Management Professionals LLC ("SMP")[2] | (880) | (1,134) |
| Physical therapy services provided to Black Hills Surgery Center by Black Hills Orthopaedic and Spine Center ("BHOSC")[6] and Neurosurgical & Spinal Surgery Associates ("NSSA")[7] | 173 | 119 |
| Intraoperative monitoring services provided to Black Hills Surgery Center by NSSA | 351 | 150 |
| Certain physician's services provided to Dakota Plains Surgical Center by Orthopaedic Surgery Specialists ("OSS")[8] | 120 | 118 |

*Note 1: Amounts for Oklahoma Spine Hospital, LLC are from June 21, 2005, the date of its acquisition by the Corporation.*

*Note 2: Surgical Physicians owns 49% of Sioux Falls Surgical Center, LLP. As of December 31, 2006, a net amount of $2 was receivable from Surgical Physicians. As of April 1, 2006 SMP was spun out of Surgical Physicians and became a stand- alone entity. As of December 31, 2006, $78 was receivable from SMP.*

*Note 3: Certain indirect minority owners of Sioux Falls Surgical Center, LLP are also owners of the Center Inn.*

*Note 4: Certain indirect minority owners of Oklahoma Spine Hospital, LLC own approximately 45% of IMD. The service agreement is automatically renewed for three-year periods (renewed in August 2005). As of December 31, 2006, $135 owing to IMD for services obtained was included in accounts payable (as of December 31, 2005: $166).*

*Note 5: SC Meridian is an entity controlled by an officer of the Corporation. The Corporation uses the chartered aircraft primarily for certain of its acquisition activities.*

*Note 6: Certain indirect minority owners of Black Hills Surgery Center, LLP are also owners of the BHOSC. As of December 31, 2006, $12 owing to BHOSC for services obtained was included in accounts payable.*

*Note 7: Certain indirect minority owners of Black Hills Surgery Center, LLP are also owners of the NSSA.*

*Note 8: Certain indirect minority owners of Dakota Plains Surgical Center, LLP are also owners of the OSS.*

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**11. Related party transactions (continued):**

(b) Real estate lease contracts:

| | 2006 $ | 2005[1] $ |
|---|---|---|
| Additional office space leased by Sioux Falls Surgical Center, LLP from Center Inn[2] | 33 | 57 |
| Facility building leased by Oklahoma Spine Hospital, LLC from Memorial Property Holdings, LLP ("MPH")[3] | 1,488 | 918 |
| Additional office space leased by Oklahoma Spine Hospital, LLC from MM Property Holdings, LLP ("MM Property")[4] | 157 | 96 |

*Note 1: Amounts for Oklahoma Spine Hospital, LLC are from June 21, 2005, the date of its acquisition by the Corporation.*

*Note 2: Certain equity owners of Sioux Falls Surgical Center, LLP are also owners of the Center Inn.*

*Note 3: The majority of the owners of MPH are also indirect minority owners of Oklahoma Spine Hospital, LLC. See note 13 for disclosure of the future rental payment commitments under the contracts with the related parties.*

*Note 4: MM Property is owned by two physicians that also own equity membership units in Oklahoma Spine Hospital, LLC. See note 13 for disclosure of the future rental payment commitments under the contracts with the related parties.*

(c) Other transactions:

Physicians, who through four companies indirectly own the minority interests in each of the Centers, routinely provide professional services directly to patients utilizing the facilities of the Centers and reimburse the Centers for the space and staff utilized. Certain of the physicians serve on the boards of management of the Centers and three such individuals perform the duties of Medical Director at the respective Centers and are reimbursed in recognition of their contribution to the Centers.

Included in the balance of prepaid expenses and other is a note receivable from Oklahoma Physical Therapy ("OPT") in the amount of $175. Certain owners of OPT are also indirect minority owners of Oklahoma Spine Hospital, LLC. This note is repayable in monthly blended payments of $5 (including interest at 5% per annum) through November 2009.

Oklahoma Spine Hospital, LLC purchased an MRI machine from Oklahoma Diagnostic Imaging ("ODI"), an entity owner by certain indirect owners of the Center, for one dollar. The machine was recorded at its fair value of $125, which included cash paid for installation costs of approximately $30. Deferred revenue of approximately $95 was recorded for the estimated future discounts to be provided to ODI.

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

## 12. Foreign exchange contracts:

At December 31, 2006, the Corporation had forward foreign exchange contracts outstanding under which the Corporation will sell U.S. dollars each month for a fixed amount of Canadian dollars on the following terms:

| Contract Dates | US$ to be delivered *($millions)* | Cdn$ to be received *($millions)* | Cdn$ per US$ *(Weighted Average)* |
|---|---|---|---|
| Jan 2007 – Dec 2007 | 24.0 | 30.6 | 1.2750 |
| Jan 2008 – Dec 2008 | 25.7 | 30.4 | 1.1829 |
| Jan 2009 – Feb 2010 | 33.3 | 37.1 | 1.1141 |
| | 83.0 | 98.1 | |

The foregoing contracts have a fair value as of December 31, 2006 of $2.4 million (December 31, 2005 - $6.9 million), which amount has been recognized in the Corporation's consolidated financial statements.

The Corporation has deposited $4.5 million (2005: $4.5 million) as collateral to ensure its performance under these contracts. The deposit is classified as restricted cash on the consolidated balance sheet.

## 13. Commitments and contingencies:

(a) Commitments:

The Centers lease certain equipment under non-cancellable long-term leases. In addition, Oklahoma Spine Hospital, LLC leases its facility building and additional office space from related entities (See note 11 for description of relationships with these entities). Minimum payments for these leases are as follows:

| | Non-Related Parties $ | Related Parties $ | Total $ |
|---|---|---|---|
| 2007 | 768 | 1,645 | 2,413 |
| 2008 | 619 | 1,645 | 2,264 |
| 2009 | 513 | 1,645 | 2,158 |
| 2010 | 397 | 1,645 | 2,042 |
| 2011 | 285 | 1,645 | 1,930 |
| Thereafter | - | 4,722 | 4,722 |
| | **2,582** | **12,947** | **15,529** |

(In thousands of U.S. dollars except per shares amounts and where otherwise indicated)

**13. Commitments and contingencies (continued):**

(b) Contingencies

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

**14. Loss on foreign currency:**

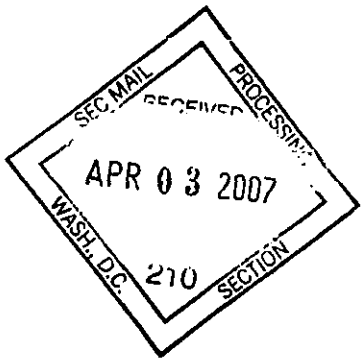
Loss on foreign currency included in the statement of income consists of the following:

| | 2006<br>$ | 2005<br>$ |
|---|---|---|
| Unrealized loss (gain) on the subordinated notes payable | (294) | 5,553 |
| Unrealized loss (gain) on the foreign exchange forward contracts | 4,476 | (1,200) |
| Unrealized (gain) on the cash balances denominated in Cdn$ | 79 | (374) |
| Realized (gain) on the hedge contracts that matured in the current period | (4,007) | (2,258) |
| Loss on foreign currency | 254 | 1,721 |

**15. Comparative financial statements:**

Certain prior year balances have been reclassified to conform with the presentation adopted in the current year.

File Number 82-34942




MEDICAL FACILITIES CORPORATION

# ANNUAL INFORMATION FORM

March 30, 2007

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## GLOSSARY OF TERMS

In this annual information form, the following terms have the meanings set forth below, unless otherwise indicated words imparting the singular include the plural and vice versa and words imparting any gender include all genders.

"Black Hills" means Black Hills Surgery Center, LLP, a South Dakota limited liability partnership.

"Canadian GAAP" means the accounting principles generally accepted in Canada.

"CDS" means The Canadian Depository for Securities Limited.

"Closing" means the closing of the IPO on March 29, 2004.

"Code" means the United States Internal Revenue Code of 1986, as amended.

"Common Shares" means the common shares in the capital of the Issuer.

"Continuing Interests" means the 35% partnership interest in each MFC Partnership that is not exchangeable for IPSs or transferable by the respective Subco.

"CPI" means the consumer price index for Canada as published by the Federal Government of Canada.

"CT" means computed tomography, sometimes called CAT scan, which is the use of special x-ray equipment to obtain image data from different angles around the body, which data is then computer processed to generate a cross-section of body tissues and organs.

"Dakota Plains" means Dakota Plains Surgical Center, LLP, a South Dakota limited liability partnership.

"EBITDA" means earnings before interest, income taxes, depreciation and amortization and other non-recurring costs.

"Exchange Agreements" means collectively, the Original Exchange Agreement and the OSH Exchange Agreement.

"Exchangeable Interests" means the 14% partnership interest in each MFC Partnership that is exchangeable for IPSs by the respective Existing Partners, through their ownership interest in the related Holding Entity and Subco to the extent that such interest has not yet been exchanged.

"Existing Partners" means the existing partners of each MFC Original Partnership prior to Closing and the existing partners of the OSH prior to the closing of the Subsequent Offering.

"First Supplemental Note Indenture" means the supplement to the Indenture between the Issuer and Computershare Trust Company of Canada, as trustee, dated June 21, 2005.

"Fully Diluted Basis" assumes that the entire Retained Interest has been converted into IPSs and that the Continuing Interests were exchanged on the same basis as the Exchangeable Interests.

"Guarantee" means the Subordinated Note Guarantee and Subco Guarantee of each MFC Partnership in respect of the Subordinated Notes and Subco Notes, respectively.

"HMOs" means health maintenance organizations.

"Holder" means a holder of IPSs, Subordinated Notes or Common Shares.

"Holding Entity" in respect of an MFC Partnership means the South Dakota or Oklahoma limited liability company that holds 100% of the membership interests in its related Subco.

"Indenture" means the Subordinated Note Indenture, as supplemented by a First Supplemental Note Indenture between the Issuer and Computershare Trust Company of Canada, as trustee.

"Intercreditor Agreement" means the intercreditor agreement among each Original Holding Entity and the trustee under the Indenture.

"Investment Agreement" means the agreement among the Issuer, Medical Facilities USA, each Original Subco, each Original Holding Entity and each MFC Original Partnership respecting, among other things, the acquisition by Medical Facilities USA of a 51% partnership interest in each MFC Original Partnership.

"IPO" means the initial public offering of IPSs of the Issuer which occurred on March 29, 2004, referred to in the section entitled "General Development of the Business".

"IPS" means an income participating security in the capital of the Issuer, comprised of one Common Share and Cdn$5.90 aggregate principal amount of Subordinated Notes.

"IRS" means the United States Internal Revenue Service.

"Issuer" means Medical Facilities Corporation, a corporation formed under the laws of the Province of Ontario.

"Management" refers to the management of the Issuer and Medical Facilities USA.

"Medical Facilities USA" means Medical Facilities Holdings (USA), LLC, a limited liability company formed under the laws of Delaware.

"MFC Hospital" or "MFC Hospitals" means individually and collectively, the surgical facilities owned by each of Black Hills, Dakota Plains, Sioux Falls and OSH, which are licensed under either South Dakota or Oklahoma Law, as specialty hospitals.

"MFC Management" refers to the management of the MFC Partnerships, or of a particular MFC Partnership, where indicated.

"MFC Original Partnership" or "MFC Original Partnerships" means individually and collectively, Sioux Falls, Black Hills and Dakota Plains.

"MFC Partnership" or "MFC Partnerships" means individually and collectively, Sioux Falls, Black Hills, Dakota Plans and OSH.

"MRI" means magnetic resonance imaging.

"Non-Management" means an individual who is a representative of an MFC Hospital, as well as a manager of Medical Facilities USA, other than Drs. Schellpfeffer or Teuber, or any further individual specified to be excluded from the above definition.

"Non-U.S. Holder" means a Holder that is not: (i) a citizen or individual resident in the U.S. for U.S. federal tax purposes, (ii) a corporation or other entity taxable as a corporation created or organized under the laws of the U.S. or a political subdivision thereof, (iii) an estate, the income of which is subject to U.S. federal income tax regardless of the source, or (iv) a trust, if (A) a court within the U.S. is able to exercise primary supervision over the trust's administration and one or more U.S. persons have the authority to control all of its substantial decisions, or (B) the trust was in existence on August 20, 1996 and has properly elected under applicable Treasury Regulations to continue to be treated as a United States person.

"Operating Agreement" means the operating agreement in respect of Medical Facilities USA among the Issuer, Medical Facilities USA, each Subco and each MFC Partnership.

"Original Exchange Agreement" means the agreement dated March 29, 2004 among the Issuer, Medical Facilities USA and each Original Subco and any other parties agreeing to be bound by that agreement providing for the Exchangeable Interests in each MFC Original Partnership.

"Original Holding Entity" in respect of an MFC Original Partnership means the South Dakota limited liability company that holds 100% of the membership interests in its related Original Subco.

"Original Subcos" or "Original Subco" in respect of an MFC Partnership means the South Dakota limited liability company that holds a 49% partnership interest in its related MFC Original Partnership (prior to any exchange of Exchangeable Interests).

"OSH" means Oklahoma Spine Hospital, LLC, an Oklahoma limited liability company.

"OSH Credit Facility'' means the $5 million revolving credit facility dated May 31, 2005 extended to OSH by Stillwater National Bank and Trust Company with a 5 year maturity.

"OSH Exchange Agreement" means the agreement dated June 21, 2005 among the Issuer, Medical Facilities USA and OSH's related Subco and any other parties agreeing to be bound by that agreement providing for the Exchangeable Interests in OSH.

"OSH Intercreditor Agreement" means the intercreditor agreement dated June 21, 2005 among OSH's related Holding Entity and the trustee under the Indenture.

"OSH Subco Guarantee" means the limited cash flow guarantee by OSH's related MFC Partnership of the OSH Subco Notes.

"OSH Subco Notes" means the subordinated notes issued by OSH's related Subco to its Holding Entity.

"OSH Subordinated Note Guarantee" means the limited cash flow guarantee by OSH of the Subordinated Notes.

"Partnership Agreement" in respect of an MFC Partnership means the amended and restated partnership agreement or amended and restated operating agreement, as applicable, between the related Subco and Medical Facilities USA.

"PPOs" means preferred provider organizations.

"Retained Interest" means the 49% partnership interest held by each Subco in its related MFC Partnership prior to any exchange of Exchangeable Interests.

"Sioux Falls" means Sioux Falls Surgical Center, LLP, a South Dakota limited liability partnership.

"South Dakota MFC Hospital" or "South Dakota MFC Hospitals" means individually and collectively, the surgical facilities owned by each of Black Hills, Dakota Plains and Sioux Falls, which are licensed under South Dakota Law, as specialty hospitals.

"specialty hospital" means a hospital that is licensed as a specialty or specialized hospital.

"Spine Hospital" means, the surgical facilities owned by OSH, which is licensed under Oklahoma Law, as a specialty hospital.

"Subco Guarantee" means the limited cash flow guarantee by each MFC Original Partnership of the Subco Notes.

"Subco Notes" means the subordinated notes issued by each Original Subco to their respective Holding Entity.

"Subcos" or "Subco" in respect of an MFC Partnership means the South Dakota or Oklahoma limited liability company that holds a 49% partnership interest in its related MFC Partnership (prior to any exchange of Exchangeable Interests).

"Subordinated Note Guarantee" means the limited cash flow guarantee by each MFC Original Partnership of the Subordinated Notes.

"Subordinated Notes" means the 12.5% subordinated notes of the Issuer issued in accordance with the Indenture.

"Subsequent Offering" means the subsequent offering of IPSs of the Issuer which was completed on June 21, 2005, referred to in the section entitled "General Development of the Business".

"Subsequent Offering Underwriting Agreement" means the underwriting agreement dated June 6, 2005 among the Issuer, Medical Facilities USA, OSH and its related Subco and Holding Entity and the Subsequent Underwriters relating to the subsequent offering.

"Subsequent Underwriters" means BMO Nesbitt Burns Inc., TD Securities Inc., RBC Dominion Securities Inc., Canaccord Capital Corporation and Sprott Securities Inc., the underwriters of the Subsequent Offering.

"surgical facilities" means medical facilities where surgical procedures are performed which include, ambulatory surgical centers, speciality hospitals and general hospitals.

"Tax Act" means the *Income Tax Act* (Canada) and the regulations thereunder, in each case in effect on the date hereof.

"Treasury Regulations" means the U.S. Treasury regulations (including final, temporary and proposed regulations) promulgated under the Code.

"Trustee" means Computershare Trust Company of Canada.

"Underwriters" means BMO Nesbitt Burns Inc., TD Securities Inc., RBC Dominion Securities Inc., National Bank Financial Inc. and Canaccord Capital Corporation, the underwriters of the IPO.

"Underwriting Agreement" means the underwriting agreement among the Issuer, Medical Facilities USA, the MFC Original Partnerships and their related Subcos and Holding Entities and the Underwriters dated March 17, 2004.

"U.S. GAAP" means the accounting principles generally accepted in the United States.

"U.S. Holder" means any Holder that is not a Non-U.S. Holder.

# MEDICAL FACILITIES CORPORATION

# ANNUAL INFORMATION FORM

## GENERAL

The information, including any financial information, disclosed in this Annual Information Form is stated as at December 31, 2006 or for the year ended December 31, 2006, as applicable, unless otherwise indicated. **Certain capitalized terms used in this Annual Information Form have the meaning set out in the "Glossary of Terms".** Unless otherwise indicated, all dollar amounts are expressed in U.S. dollars and references to "$" are to the lawful currency of the United States.

Certain statements in this Annual Information Form may constitute "Forward-looking statements", which reflect the expectations of Management and MFC Management regarding future growth, results in operations, performance and business prospects and opportunities of the Issuer, Medical Facilities, USA and the MFC Partnerships. Such forward-looking statements reflect Management's and MFC Management's current beliefs and speak only as of the date of this Annual Information Form. Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not or the times at or by which such performance or results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed in the section entitled "Risk Factors". Although the forward-looking statements contained in this Annual Information Form are based upon what Management and MFC Management believe are reasonable assumptions, the Issuer, Medical Facilities USA and the MFC Partnerships cannot assure investors that actual results will be consistent with these forward-looking statements, and the differences may be material. These forward-looking statements are made as of the date of this Annual Information Form and none of the Issuer, Medical Facilities USA and the MFC Partnerships or their respective management assumes any obligation to update or revise them to reflect new events or circumstances.

## CORPORATE STRUCTURE

The Issuer was incorporated under the *Business Corporations Act* (Ontario) on January 12, 2004 and was continued under the laws of the Province of British Columbia on May 16, 2005. The registered office of the Issuer is located at 355 Burrard Street, Vancouver, British Columbia and the head office of the Issuer is located at 250 Yonge Street, Toronto, Ontario. The Issuer was established to hold 100% of the membership interests in Medical Facilities USA.

### Medical Facilities USA

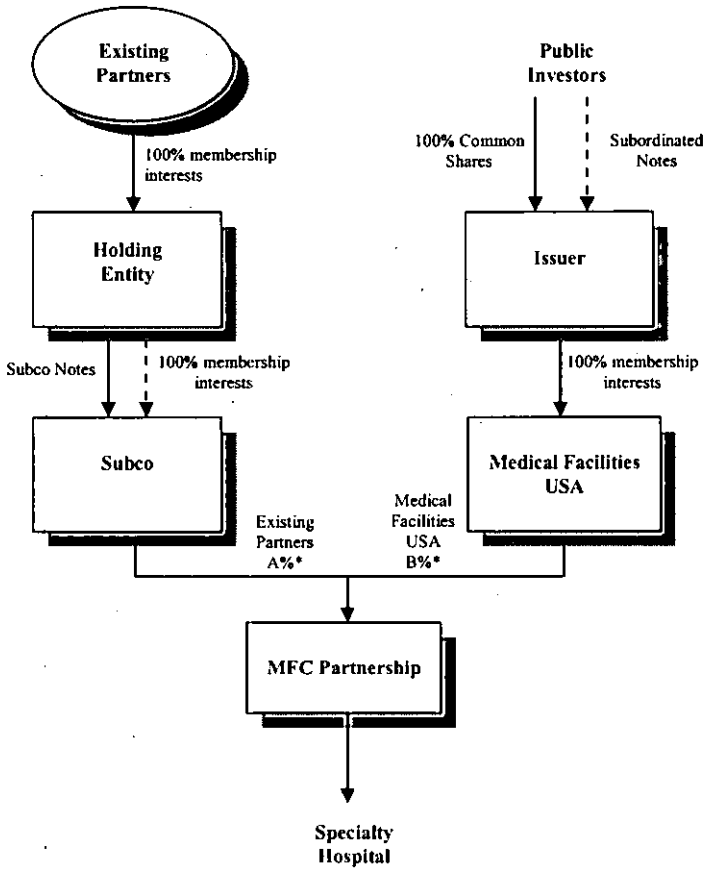
Medical Facilities USA is a Delaware limited liability company with its registered and head office located at the Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware. The Issuer formed Medical Facilities USA on March 12, 2004 for the purpose of acquiring a 51% partnership interest in each MFC Partnership.

### MFC Partnerships

Each MFC Original Partnership is a limited liability partnership formed under the laws of South Dakota. The registered and head office of each MFC Partnership is as follows: Black Hills is located at 216 Anamaria Drive, Rapid City, South Dakota, Dakota Plains is located at 701 8th Avenue North West, Aberdeen, South Dakota, Sioux Falls is located at 910 East 20th Street, Sioux Falls, South Dakota and OSH is located at Two Leadership Square, 10th Floor, 211 North Robinson, Oklahoma City, Oklahoma.

**Ownership Structure**

The following chart illustrates the ownership structure of each MFC Partnership:




(*) See the table below for a breakdown of ownership in the MFC Partnerships. Percentage A represents the Retained Interest, comprised of an Exchangeable Interest and a 35% Continuing Interest, beneficially owned by the Existing Partners through their membership interests in their related Holding Entity and Subco. Percentage B represents the partnership interest in each MFC Partnership held by Medical Facilities USA.

| MFC Partnership | A% | B% |
|---|---|---|
| Sioux Falls | 49% | 51% |
| Black Hills | 47.05% | 52.95% |
| Dakota Plains | 49% | 51% |
| OSH | 49% | 51% |

## GENERAL DEVELOPMENT OF THE BUSINESS

On March 29, 2004, the Issuer closed the initial public offering of 22,173,212 IPSs at a price of Cdn$10.00 per IPS for gross proceeds of Cdn$221,732,120 (the "IPO"). The net proceeds of the IPO of Cdn$202.4 million were used by the Issuer to subscribe for membership interests in Medical Facilities USA (which constituted of all of the outstanding securities of Medical Facilities USA).

Upon completion of these transactions, Medical Facilities USA owned 51% of the partnership interests in each MFC Original Partnership. The aggregate cash consideration paid for such 51% partnership interest was the following: $68,572,302 for Black Hills; $11,196,906 for Dakota Plans; and $63,891,504 for Sioux Falls.

On June 21, 2005, the Issuer completed the acquisition of a 51% interest in OSH as well as an offering, on a bought-deal basis (the "Subsequent Offering") of 5,420,000 IPS at a price of $13.25 per IPS for gross proceeds of Cdn$71,815,000. The Issuer used approximately US $44,100,000 of the proceeds of the Subsequent Offering to acquire the 51% interest in OSH. The Business Acquisition Report dated November 18, 2005 in connection with the acquisition of OSH is incorporated herein by reference. The Business Acquisition Report is available on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com.

On December 22, 2006, the Toronto Stock Exchanged approved a proposed normal course issuer bid by the Issuer. Under the terms of the issuer bid, the Issuer will be entitled to purchase up to 840,000 of its IPSs during the period from December 28th, 2006 to December 27th, 2007. Any tendered units taken up and paid for by the Issuer under the issuer bid will be cancelled. 20,000 IPSs have been purchased for cancellation under the bid for an aggregate consideration of Cdn$178,350.

## DESCRIPTION OF THE BUSINESS

### Business of the Issuer and Medical Facilities USA

The Issuer is a corporation continued under the laws of British Columbia and established to hold 100% of the membership interests in Medical Facilities USA, a Delaware limited liability company. Medical Facilities USA holds a 51% partnership interest or greater in each MFC Partnership. The Issuer and Medical Facilities USA do not have any ongoing business operations of their own. Medical Facilities USA depends on the operations and assets of the MFC Hospitals for cash distributions on its partnership interests in the MFC Partnerships. The Issuer, in turn, depends on Medical Facilities USA for cash distributions to satisfy the interest obligations of the Subordinated Notes and to pay dividends on the Common Shares.

Although the business and operations of each MFC Hospital are under the control and direction of management of each facility, Medical Facilities USA exercises general oversight over these facilities through contractual rights which provide that certain matters are subject to the approval of the Medical Facilities USA board of managers, including any reduction in distributions, certain budgeting matters, material deviations from budget and specified fundamental transactions.

The board of directors of the Issuer consists of eight members, a majority of whom are unrelated to the Issuer and its subsidiaries. The board of managers of Medical Facilities USA consists of eleven managers, of whom a majority are unrelated to Medical Facilities USA and the MFC Partnerships, six of whom are nominees of the Issuer and five of whom are nominees of the MFC Partnerships.

The board of managers and management of Medical Facilities USA are responsible for administering the affairs of Medical Facilities USA; working co-operatively with MFC Management to identify and implement operational best practices; assisting the MFC Hospitals to realize all potential synergies among them; and identifying strategic acquisition opportunities. The surgical facility industry is highly fragmented. As such, there are a number of specialty hospitals and ambulatory surgical centers that may provide accretive growth opportunities for the Issuer. The board of managers and management of Medical Facilities USA are responsible for identifying, negotiating and structuring the acquisition of additional surgical facilities. Accretive acquisitions may enhance distributable cash flow growth, increase the potential for synergies among the MFC Hospitals and provide additional diversification.

**Business of the MFC Hospitals**

***Business Overview***

The MFC Partnerships own and operate the MFC Hospitals. Each MFC Hospital is a licensed speciality hospital which performs scheduled (as opposed to emergency) surgical, imaging and diagnostic procedures. The MFC Hospitals do not offer the full range of services typically found in traditional hospitals, but instead focus on a limited number of clinical specialties, including orthopaedic; ear, nose and throat; neurosurgery; and other surgical procedures.

Three of the MFC Hospitals are located in South Dakota and the fourth MFC Hospital is located in Oklahoma. The South Dakota MFC Hospitals are three of the largest specialty hospitals in South Dakota and are situated in Sioux Falls, Rapid City and Aberdeen, the major population centers on the east, west and north sides of the state and service patients throughout South Dakota and surrounding states. The Spine Hospital, one of the United States' first physician-owned and operated specialty surgical spine hospitals, is located in Oklahoma City, the state capital of Oklahoma. Collectively, the MFC Hospitals have 30 operating rooms, 51 recovery beds, 591 physicians with medical staff privileges and a clinical staff of 456.

The MFC Hospitals focus on providing high quality surgical facilities that meet the needs of their patients, physicians and payors better than competing surgical facilities in their markets. MFC Management believe that their facilities:

- Enhance the quality of care and the healthcare experience of patients;
- Offer significant administrative, clinical and professional benefits to physicians;
- Offer a competitive alternative to payors; and
- Are well positioned to grow by taking advantage of the increasing demand for surgical procedures.

The business model of the MFC Hospitals has been developed to encourage physicians to practice at the MFC Hospitals. The scheduling, staffing, clinical procedures and protocols at each MFC Hospital are designed to increase physician productivity and professional fee potential. MFC Management believes that a high level of physician satisfaction and the provision of high quality healthcare in a non-institutional and convenient environment for patients, combined with favourable demographic trends and ongoing medical advancements, will continue to increase the number and complexity of procedures performed at the MFC Hospitals each year.

By successfully executing a business strategy that emphasizes patient and physician satisfaction, operating efficiency and margin improvement, the MFC Hospitals on a combined basis have continued to experience growth in net revenues and EBITDA.

***Business and Growth Strategies***

MFC Management intends to continue to maintain and enhance the operating efficiency of each MFC Hospital and maintain and enhance cash available for distribution by the Issuer by executing the following business and growth strategies:

- *Attract and Retain Quality Healthcare Professionals.* The MFC Partnerships intend to continue to attract and retain quality healthcare professionals. MFC Management believes that the MFC Partnerships have been successful in attracting and retaining quality physicians because of the ownership and management structure and the staffing, scheduling and clinical procedures and protocols in place which are designed to increase a physician's productivity and professional fee income, promote his/her professional success, provide control over his/her practice, and enhance the quality of patient care.

- *Maintain and Enhance Operating Margins and Efficiency.* The clinical and operational procedures in place at each MFC Hospital are designed to maximize operational efficiencies. By focusing on a limited number

of specialized procedures, the MFC Hospitals are able to develop and implement clinical and administrative best practices which increase physician productivity. Each MFC Hospital will continue to refine its case mix in an effort to enhance its operating efficiency. Management will be responsible for identifying and achieving potential synergies among the MFC Hospitals, including the implementation of best practices, standardizing reporting and information systems and equipment and supplies, participating in group purchasing programs and consolidating the MFC Hospitals' benefit programs.

- *Proactive Marketing.* The MFC Hospitals will continue to undertake proactive marketing activities directed at physicians, other healthcare providers, patients and payors. These activities generally emphasize the benefits offered by the individual MFC Hospital compared to other healthcare facilities in their respective market, such as the ability to schedule consecutive cases without pre-emption by emergency procedures, the efficient turnaround time between cases, the simplified administrative procedures utilized at each facility and the overall patient satisfaction. The MFC Hospitals also market their hospitals directly to payors, including HMOs, PPOs and other managed care organizations, employers and other payors. Payor marketing activities conducted by the MFC Hospitals emphasize the high quality of care, cost advantages and convenience of the hospitals.

- *Expansion of Procedures and Facilities.* The MFC Hospitals will endeavour to increase revenues and operating efficiency by the disciplined introduction of new and more complex surgical and pain management procedures through the continued recruitment of specialist physicians. In addition, as the demand for surgical procedures at the MFC Hospitals increases, the facilities can be expanded to include additional operating rooms, recovery rooms and equipment subject to certain federal and state regulatory and licensing requirements as well as local zoning and permitting requirements.

- *Acquisition of Additional Hospitals.* The execution of accretive acquisitions will allow for the growth of cash available for distribution. In addition management believes that accretive acquisitions will enhance the potential for operational efficiencies, including the implementation of operational best practices, standardization of equipment and supplies and group purchasing programs. Finally, management believes that acquisitions will enhance the stability of the Issuer's subsidiaries' operations through a broadened geographic base and diversification of their payor base and case mix and increasing its profile within the medical community in the United States, thereby enhancing its ability to identify and attract future acquisition opportunities.

***Competitive Strengths***

Management believes that the MFC Partnerships are successfully capitalizing on an attractive market opportunity in the healthcare industry. There are a number of competitive strengths that have contributed to the strong historical financial performance at each MFC Partnership which management believes will continue to sustain the MFC Hospitals' financial performance and provide a platform for future growth:

- *Physician Preference.* Physician loyalty is a key to the success of the MFC Hospitals. Physician ownership and operation of each MFC Hospital has been a key factor in attracting physicians to the medical staffs of the MFC Hospitals. Physicians prefer practicing at the MFC Hospitals because they are able to increase the number of procedures they perform in a given period relative to a traditional hospital setting, thereby maximizing their efficiency and increasing professional fee potential.

- *Patient Preference.* The clinical and administrative procedures in place at each MFC Hospital are designed to improve the patient experience and ensure a high degree of patient satisfaction. Management believes that patients prefer the MFC Hospitals over traditional hospitals and other surgical facilities because they offer the comfort of a less institutional environment, a high level of customer service and convenience, simplified administration procedures and greater scheduling flexibility while providing high quality patient care. Based on recent internal patient satisfaction surveys, approximately 90% of the patient respondents rated the services at the MFC Hospitals as "excellent" and approximately 9% rated the services as "very good".

- *Payor Preference.* The MFC Hospitals offer payors a competitive alternative to traditional hospitals and enable them to offer their members a greater degree of choice for surgical, imaging and diagnostic procedures.

- *Established Reputation.* Each MFC Hospital is well established in its service area. The MFC Hospitals operated by OSH, Dakota Plains, Black Hills, and Sioux Falls have been in operation for six, seven, ten and nineteen years, respectively. MFC Management believes that the reputation of the MFC Hospitals for providing high quality clinical outcomes and excellent patient service has provided the MFC Hospitals with the ability to attract quality physicians and additional patients to the MFC Hospitals.

- *Strong and Experienced Management.* The MFC Hospitals have strong and experienced management teams focused on providing high quality care and physician and patient satisfaction. The physician dominated management structure ensures a high level of operational efficiency and assists the MFC Hospitals in attracting and retaining physicians. The executive director (or chief operating officer), medical director and chief financial officer of each MFC Hospital collectively have an average of over **[14]** years experience in healthcare administration. Management of the Issuer has extensive financial and corporate development experience and extensive relationships throughout the healthcare industry.

***Facilities, Markets Served and Competitors***

The South Dakota MFC Hospitals are located in Sioux Falls, Rapid City and Aberdeen, South Dakota each servicing a largely rural market. South Dakota has a population of 782,000 (U.S. Census 2006 estimate). The South Dakota MFC Hospitals service patients throughout South Dakota and surrounding states, including parts of Minnesota, Iowa, Nebraska, North Dakota, Wyoming and Montana. Management believes that the markets served by the South Dakota MFC Hospitals are attractive for the following reasons:

- *Less Competition.* These communities have smaller populations with fewer hospitals and other healthcare service providers. Management believes that the smaller populations and relative significance of the one or two traditional hospitals in these markets may discourage the entry of other surgical facilities, including ambulatory surgical centers, as well as rehabilitation and diagnostic and imaging centers.

- *More Favourable Payment Environment.* The lower number of healthcare providers in these markets limits the ability of managed care organizations to create price competition among local healthcare providers. Consequently, the South Dakota MFC Hospitals can often negotiate reimbursement rates with managed care plans that are more favourable, in general, than those available in urban markets.

The Spine Hospital is located in Oklahoma City, the state capital of Oklahoma. Oklahoma has a population of approximately 3,579,000 (U.S. Census 2006 estimate). Management believes that the market served by the Spine Hospital is attractive for the following reasons:

- *Specialization.* Although the Spine Hospital competes with traditional hospitals, ambulatory surgical centers and other specialty hospitals to attract physicians, employees and patients, the Spine Hospital is the only facility in the Oklahoma City metropolitan area that focuses on the treatment of disorders of the spine. Management believes that the Spine Hospital's focus on spine disorders and injuries as well as pain management, neurosurgery and orthopaedic surgery will allow it to continue to be able to compete effectively over competing facilities.

- *Established Reputation.* The Spine Hospital has been in operation for over six years and has a well-established reputation in central and western Oklahoma. Management believes that the Spine Hospital's reputation for providing high quality care and excellent patient outcomes has enabled it, and will continue to enable it, to attract physicians and patients.

***Black Hills Surgery Center***

The Black Hills Surgery Center is located in Rapid City, South Dakota and has been operating as a licensed specialty hospital since 1997. The Black Hills Surgery Center focuses primarily on orthopaedic and neurosurgical procedures. The facility is conveniently located with access to both public and private transportation.

The Black Hills Surgery Center was originally built in 1996 and is now approximately 55,000 square feet with seven operating rooms, 23 beds (licensed for 26) and a clinical staff of 134. There are currently 81 physicians who have medical staff privileges at Black Hills Surgery Center. In 1998 MRI and CT services were added and in 2001, a 20,000 square foot addition with 18 overnight rooms and support facilities was completed, in 2005, a 3 tesla MRI, the latest technology available in MRI services, was added to the operation, and as of the end of 2006, a 64-slice CT, the latest available technology in CT services, was placed in service. The facility and the underlying land are owned by Black Hills Surgery Center, LLP.

Rapid City, which is South Dakota's second largest city, has a population of approximately 66,000 while the Metropolitan Statistical Area has a population of approximately 119,000 with a median age of 36. The population growth rate in this area has been stable over the last five years. In 2005 and 2006, Rapid City was ranked sixth by Forbes Magazine as one of the nation's best small metropolitan cities for starting a business or career.

The primary competing facility for the Black Hills Surgery Center is the not-for-profit Rapid City Regional Hospital and its affiliated specialty hospital, Same Day Surgery Center. Other facilities in the area include the Sioux San Hospital primarily servicing Native Americans, Black Hills Regional Eye Institute and numerous clinics that provide healthcare services in every speciality.

The primary service area for Black Hills Surgery Center has a combined population of approximately 146,000 within a radius of 50 miles. Approximately 70% of its patients reside within this area, while a further 20% of Black Hills Surgery Center's patients reside within its secondary service area which encompasses, within a radius of 200 miles, a combined population of approximately 464,000.

***Dakota Plains Surgical Center***

The Dakota Plains Surgical Center is located in Aberdeen, South Dakota and is attached to an orthopaedic clinic that is the primary office of the orthopaedic physicians that account for 92% of the hospital's admissions. It has been operating as a licensed specialty hospital since 1998 and focuses primarily on orthopaedic procedures. The facility is conveniently located with excellent access to public and private transportation.

The Dakota Plains Surgical Center was originally built in 1998 and is approximately 13,000 square feet with three operating rooms, eight beds and a clinical staff of 31. There are currently 86 physicians who have medical privileges at Dakota Plains Surgical Center. In 2001, radiology services, including MRI, were added. The facility and the underlying land are owned by Dakota Plains Surgical Center, LLP. Aberdeen, South Dakota is located in the northeast corner of South Dakota, has a median resident age of 36.5 years and a population of approximately 24,000 (U.S. Census Bureau 2005 estimate). The population in this area has remained stable over the last five years.

Within Aberdeen there is one traditional hospital, Avera St. Luke's Hospital, in addition to numerous clinics that provide healthcare services in most specialties.

The primary service area for Dakota Plains Surgical Center has a combined population of approximately 80,000 which encompasses an area 150 miles (North and South) by 50 miles (East and West) from the facility. Approximately 76% of its patients reside within this area. A further nine percent of Dakota Plains Surgical Center's patients reside within its secondary service area which encompasses an area 170 miles (North and South) by 70 miles (East and West) from the facility with a combined population of approximately 90,000.

***Sioux Falls Surgical Center***

The Sioux Falls Surgical Center is located adjacent to the campus of Avera McKennan Hospital in Sioux Falls, South Dakota, with excellent access to public and private transportation. The Sioux Falls Surgical Center was established in October 1985 and is a multi-specialty facility which performs orthopaedic, ear, nose and throat, urology, neurosurgery, GYN, plastic, GI, pain management, general surgery, and ophthalmology procedures.

The Sioux Falls Surgical Center was originally built in 1985 and is approximately 49,000 square feet with 11 operating rooms, 13 beds and a clinical staff of 132. There are currently 333 physicians who have medical staff privileges at Sioux Falls Surgical Center. In October 1996 the Sioux Falls Surgical Center expanded its services to

include a Recovery Care Department to accommodate the post-operative needs of patients undergoing more extensive surgeries, and in 1998 radiology services were expanded to include MRI. The facility and the underlying land are owned by Sioux Falls Surgical Center, LLP. The Sioux Falls Surgical Center leases additional office space for administrative purposes in an adjacent building.

Sioux Falls, South Dakota's largest city, has a population of approximately 172,000 with a population of approximately 240,000 in the Metropolitan Statistical Area (U.S. Census Bureau 2005 estimate), which includes Lincoln and Minnehaha counties and has a median resident age of 33.6. The population growth rate in this area has averaged 2.3% over the last five years.

Within the City of Sioux Falls, there are five other hospitals, including two traditional hospitals, one paediatric hospital that does not perform surgical procedures, a veterans' hospital and a specialty cardiac hospital. There are also numerous clinics that provide healthcare services in every specialty. The health services industry in Sioux Falls is one of the city's primary industries, attracting patients from all over South Dakota, as well as from Minnesota, Iowa and Nebraska.

The primary service area for Sioux Falls Surgical Center has a combined population of approximately 435,000 within a radius of 120 miles. Approximately 70% of its patients reside within this area. A further 7% of Sioux Falls Surgical Center's patients reside within its secondary service area which encompasses, within a radius of 150 miles, the communities east of Chamberlain, South Dakota, north of Yankton, South Dakota, west of Worthington, Minnesota and south of Aberdeen, South Dakota, with a combined population of approximately 513,000 residents.

***Oklahoma Spine Hospital***

The Spine Hospital is located in Oklahoma City, Oklahoma and has been operating as a licensed specialty hospital for over six years. The Spine Hospital focuses on a limited number of clinical and surgical specialties, including neurosurgery, pain management, orthopaedic surgery and podiatry.

The Spine Hospital operates a 61,000 square foot facility with seven operating rooms, seven recovery beds and a clinical staff of 159. In addition, the Spine Hospital has two major pain management procedure rooms, 18 private patient rooms, 14 pre-op and post-op outpatient beds and category IV emergency services. There are currently 130 physicians who have medical staff privileges at the Spine Hospital.

OSH leases the Spine Hospital facility and the underlying land from Memorial Property Holdings, LLC, a company owned by many of the same physicians who own the retained interest in OSH. The lease has a term extending to 2014 with two five-year extension options in favour of OSH. OSH also leases approximately 7,000 square feet of administrative office space in an adjacent building owned by two of the physician owners of OSH and subleases approximately 3,000 square feet of medical office space to three pain management physicians.

Oklahoma City has a population of approximately 531,000 with a metropolitan area of approximately 1,157,000 (U.S. Census Bureau 2006 estimate).

The Spine Hospital competes with traditional hospitals, ambulatory surgical centers and other specialty hospitals to attract physicians, employees and patients. The Spine Hospital is the only facility in the Oklahoma City metropolitan area that focuses on the treatment of disorders of the spine.

***Case Mix***

The MFC Hospitals focus on a limited number of high volume non-emergency surgical procedures and diagnostic and imaging services. The case mix at each MFC Hospital is a function of the clinical specialties of the physicians on the medical staff and the equipment and infrastructure at each facility. Each of the MFC Hospitals intends to continue to refine its case mix as opportunities arise.

The following table sets forth the percentage of gross revenue per specialty generated in 2006 at each of the MFC Hospitals:

| Specialty | Black Hills | Dakota Plains | Sioux Falls | OSH |
|---|---|---|---|---|
| Dental/Oral | 0.00% | 0.00% | 1.46% | 0.00% |
| Ear, Nose and Throat | 1.49% | 0.00% | 13.42% | 0.00% |
| Gastroent/Urology | 1.09% | 0.00% | 4.97% | 0.00% |
| General Surgery | 2.16% | 0.05% | 4.70% | 0.00% |
| Neurosurgery | 44.61% | 0.00% | 10.11% | 34.52% |
| Obstetrics/Gynecology | 3.69% | 1.25% | 6.58% | 0.00% |
| Ophthalmology | 1.91% | 0.00% | 2.94% | 0.00% |
| Orthopaedics | 34.10% | 91.78% | 50.02% | 12.30% |
| Pain Management | 4.97% | 5.48% | 1.40% | 50.42% |
| Plastic Surgery | 0.00% | 0.00% | 3.19% | 0.00% |
| Podiatry | 1.23% | 0.02% | 1.09% | 0.00% |
| Other | 4.80% | 1.42% | 0.12% | 2.76% |
| **Total** | **100.00%** | **100.00%** | **100.00%** | **100.00%** |

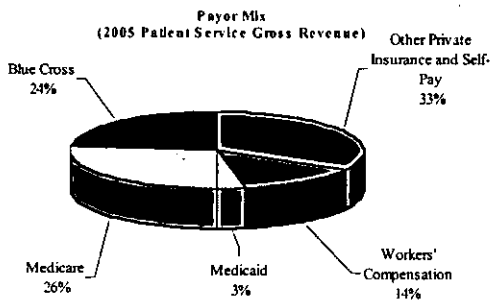
Management of each MFC Hospital will continue to implement the business strategies of increased marketing and operating efficiency through the adoption of best practices which are aimed at increasing the utilization of each facility.

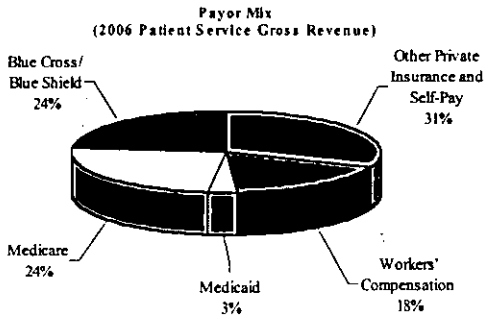
Management believes that historical levels of growth at the facilities were achieved substantially through increasing procedure volume and by focusing on clinical specialties which enhance operating efficiency and productivity. Management believes that through further refinement of scheduling incremental growth in the near term can be achieved without any significant infrastructure improvements or extension of current operating hours. As well, there is expansion capacity at each MFC Hospital to add more operating rooms, beds and related space.

***Revenue Model and Payor Mix***

Fees earned by the MFC Hospitals vary depending on the surgical procedure or related service performed and who is paying for the services. Revenues are generated, and separately invoiced, on a per-procedure basis. Generally, there are at least two fees for most surgical procedures and diagnostic and imaging services performed at the MFC Hospitals — a facility fee and a professional fee. The facility fee is paid directly to the MFC Hospital for the use of its infrastructure, surgical equipment, nursing staff, non-surgical professional services and other support services. Generally, professional fees are paid directly to the physician(s) performing the procedure and are not included in the revenue or expenses of the MFC Hospitals, except for certain fees for MRI and CT scans that are paid directly to the facilities. Overall revenue depends upon patient occupancy levels, imaging, diagnostic and surgical procedure volumes, case mix and the payment rates of the respective payors.

The MFC Hospitals receive payments for the imaging, diagnostic and surgical procedures and related services they provide from public and private health insurance plans, workers' compensation and directly from patients. The following table outlines the percentage of gross revenue generated in 2005 and 2006 from each primary payor group, these percentages have remained relatively stable over the past five years:




Note: The above charts are based on the primary payor group. Co-payment and deductible obligations paid directly by or on behalf of the patient are included as revenue attributed to the primary payor. For example, if a patient has a $500 deductible or co-payment under their insurance plan, this amount is included in the private insurance category notwithstanding the fact that the patient pays this fee directly to the MFC Hospital.

The majority of patient service revenues generated by the MFC Hospitals are based on payments received from private insurance plans, including managed care plans and self-insured employer plans. Approximately 50% of the U.S. population is covered by some form of managed care plan, including health maintenance organizations (HMOs) and preferred provider organizations (PPOs), generally obtained through the workplace. Managed care plans provide comprehensive health services to their members and frequently offer financial incentives for patients to use healthcare providers who are associated with the plan. Managed care plans and other private insurers typically negotiate discounted fee structures for surgical procedures with healthcare providers in an effort to control healthcare costs. The MFC Hospitals are well positioned to compete for surgical procedures and related services in this environment.

Government-funded public healthcare plans include Medicare and Medicaid. Medicare is a federal program that provides medical insurance benefits to persons age 65 and over, some disabled persons, and persons with end-stage renal disease. Medicaid is a federal-state funded program, administered by the states, which provides medical benefits to low-income individuals. The MFC Hospitals are participating providers for both Medicare and Medicaid services. Payments derived for services rendered to Medicare and Medicaid beneficiaries are generally lower than the customary fees charged by the MFC Hospitals to private insurance plans for similar services. Medicare's pricing model is a prospective payment system based on fixed payment rates. Amounts paid for procedures and related services under a prospective payment system are established by federal regulation and are not based on the costs incurred by the provider. As such, Medicare payment rates are established for each surgical procedure. Similarly, payments for services rendered to Medicaid beneficiaries are determined in accordance with procedures and standards established by state laws and federal guidelines.

The MFC Hospitals receive a relatively small proportion of their revenue directly from uninsured patients. In addition, insured patients are responsible for services not covered by their health insurance plans, and for deductibles, co-payments and co-insurance obligations under their plans. The amount of these deductibles, co-payments and co-insurance obligations has increased in recent years but does not represent a material component of the revenue generated by the MFC Hospitals.

The diversity and credit strength of the MFC Hospitals' payor mix has led to a bad debt ratio averaging less than three percent of net revenues over the past five years for the South Dakota MFC Hospitals and six percent of net revenues of the Spine Hospital. This higher ratio for the Spine Hospital reflects a higher percentage of co-payment and self-payment portion of total net revenues for that facility.

Although there is a noticeable trend of many patients seeking medical procedures in December and January, primarily as a result of a patient's inability to carry over unused insurance benefits into the following calendar year, the MFC Hospitals do not experience any large degree of seasonality in their revenues.

***Physicians and Ownership Structure***

In order to perform surgical procedures at the MFC Hospitals, a physician must meet certain professional credentialing requirements established by each MFC Hospital. Physicians practicing at the MFC Hospitals include both physicians (and other professionals) with an ownership interest in the facilities and non-investors. To promote quality and competency, the MFC Hospitals do require physicians, among other things, to perform a minimum number of procedures at their respective MFC Hospital to retain their medical staff privileges.

The following chart outlines the ownership structure of each MFC Partnership as at December 31, 2006:

| MFC Hospital | Number of Physician Investors[1] | Total Number of Physicians Credentialed at each Facility | Percentage of Physicians who are Investors |
|---|---|---|---|
| Black Hills | 32 | 81 | 39.51% |
| Dakota Plains | 6 | 86 | 6.98% |
| Sioux Falls | 58 | 333 | 17.42% |
| OSH | 24 | 130 | 18.46% |
| **Total** | **120** | **630** | **19.05%** |

(1) Included in this number are a limited number of dentists and podiatrists who are investors and have medical staff privileges at the MFC Hospital, but are not licensed physicians.

***Management and Employees***

Each MFC Partnership has a management committee consisting primarily of physician investors elected for fixed terms by the Existing Partners of that MFC Partnership. The management committee is responsible for overseeing all operational and strategic initiatives of the hospital including physician recruitment and accreditation, facilities management and maintenance, administrative and human resources and all financial matters including approving payor arrangements. Sioux Falls Surgical Center has an executive director, medical officer, chief financial officer and certain other administrative employees. Black Hills has a physician executive, chief executive officer/general counsel, chief financial officer, and certain other managers. Dakota Plains has a site manager, medical director and outsources its other management and administrative functions to Sioux Falls. The Spine Hospital has a chief executive officer, chief operating officer, medical director and outsources its other management and administrative functions.

The staff of each MFC Hospital generally includes registered nurses, operating room technicians, radiology technicians and clerical and other support staff. None of the MFC Hospitals' employees are represented by a collective bargaining agreement. Management believes that each MFC Hospital has a good relationship with its employees and each offers its employees a competitive compensation package. A summary of the staffing profile at each MFC Hospital is provided in the table below as at December 31, 2006:

| | Clinical | | Non-Clinical | | |
|---|---|---|---|---|---|
| Facility | Full-Time | Part-Time | Full-Time | Part-Time | Total |
| Black Hills | 113 | 21 | 81 | 18 | 233 |
| Dakota Plains | 23 | 8 | 5 | 1 | 37 |
| Sioux Falls | 72 | 60 | 51 | 6 | 189 |
| OSH | 101 | 58 | 35 | 42 | 236 |
| **Total** | **309** | **147** | **172** | **67** | **695** |

The MFC Hospitals have experienced a high degree of physician and nurse retention as a result of the quality of services delivered and focus on both employee and patient satisfaction. Management at the MFC Hospitals believes that the MFC Hospitals provide a less institutionalized work environment than traditional hospitals and improved working conditions for both nurses and staff as a result of limited number of night shifts and call duty and encourage their staff to continually upgrade their clinical and customer service skills through formal

and informal training and mentoring. The shortage of nurses generally affecting hospitals and other healthcare facilities in the United States has had limited impact on the MFC Hospitals' ability to attract and retain nurses.

***Competition***

The hospital industry is highly competitive. In each market in which the MFC Hospitals operate, there is competition with traditional hospitals, ambulatory surgical centers and other specialty hospitals to attract both physicians and patients. Patients in the MFC Hospitals' primary service areas may travel to these other healthcare facilities for a variety of reasons, including the need for services not offered at the MFC Hospitals, physician referrals or coverage by applicable insurance programs. MFC Management believes that a facility's competitive position in the market in which it operates is affected by a number of factors, including: the scope, breadth and quality of services offered to its patients and physicians; the number, quality and specialties of the physicians who refer patients; nurses and other healthcare professionals employed or on its staff; its reputation; its managed care contracting relationships; the extent to which it is part of an integrated healthcare delivery system; its location; the location and number of competitive facilities and other healthcare alternatives; the physical condition of its buildings and improvements; the quality, age and state of the art of its medical equipment; its parking or proximity to public transportation; the length of time it has been a part of the community; and its charges for services. In addition, some of the facilities that compete with the MFC Hospitals are owned by not-for-profit entities supported by endowments and charitable contributions. These hospitals are not subject to sales, property and income taxes. Because of the strong position the MFC Hospitals enjoy in the markets where the MFC Hospitals are located, MFC Management believes that the MFC Hospitals are well positioned to compete for both physicians and patients in the markets in which the hospitals operate.

There are a number of barriers to entry for new entrants into the surgical facilities market in the markets served by the MFC Hospitals, including regulatory, licensing and capital requirements. In addition, the South Dakota and Oklahoma markets are already serviced by a number of excellent healthcare facilities, including the MFC Hospitals, thereby increasing the difficulty in attracting both physicians and patients to a new surgical facility.

***Capital Expenditures***

The capital expenditures of the MFC Hospitals can be categorized into two types: maintenance and growth or earnings enhancing. The table below sets out the historical and average maintenance and growth capital expenditures of the MFC Hospitals for the past five years:

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | **2006** | **2005[2]** | **2004[2]** | **2003[2]** | **2002[2]** | **Average** |
| | | | **(US$ Millions)** | | | |
| Maintenance Capital Expenditures (net) | 2.0 | 1.8 | 1.8 | 1.6 | 1.6 | 1.8 |
| Growth Capital Expenditures (net)[1] | 0.9 | 3.9 | 0.5 | 1.6 | 1.6 | 1.7 |
| Total | 2.9 | 5.7 | 2.3 | 3.2 | 3.2 | 4.3 |

(1) Amount for 2006 represents the acquisition and installation of a laser guided C-Arm and a store room addition at Sioux Falls Surgical Center.

(2) Include amounts prior to acquisition of respective centers by Medical Facilities USA.

***Maintenance Capital Expenditures***

Maintenance capital expenditures include those required to maintain and upgrade existing infrastructure, including the replacement of furnishings and routine maintenance to existing building structures and the surrounding landscape. In addition, the MFC Hospitals routinely replace existing operating equipment and surgical devices. The management information systems of the MFC Hospitals must also be maintained and upgraded from time to time.

***Growth Capital Expenditures***

Growth capital expenditures are those related to the acquisition of new equipment, expansion of existing infrastructure (i.e., expansion of existing building facilities and/or addition of operating rooms or recovery beds) and

other capital improvements. Growth capital expenditures are intended to increase productivity and cash flows, enhance margins and/or increase capacity.

In 2002 and 2003, Black Hills spent $1.1 million was spent primarily to expand the waiting area and administrative office space at the facility to better accommodate the increased patient volume as a result of expansion projects completed in 2001. In 2005, Black Hills completed the expansion of its imaging facility at a cost of approximately $4.3 million, consisting of $2.5 million for the imaging equipment, which was financed by an affiliate of the vendor over five years, and approximately $1.8 million for construction.

In 2003, Dakota Plains spent $45,000 on additional surgical equipment and Sioux Falls purchased a new MRI for $1.1 million, of which $660,000 represented the incremental value of the new "open MRI technology" over the older model that it replaced. Eight additional beds were added to the Post Anesthesia Care Unit in 2002 and 2003 at a cost of $1.2 million, further expanding the capacity of the facility. Additional operating equipment was purchased in 2002 and 2003 for $300,000. In 2006, Sioux Falls purchased a laser guided C-Arms and built a store room addition. The additional room was used to relocate current storage space and create room for additional operating space.

***Outlook***

Maintenance capital expenditures have averaged $1.8 million (or 1.6% of the average annual net revenues) over the past five years. MFC Management anticipates that in order to sustain the current capacity and utilization of the facilities, infrastructure and equipment of the MFC Hospitals, maintenance capital expenditures will range between 1.8% and 2.2% of net revenues for the foreseeable future. In addition to cash generated from operations, the MFC Hospitals have the ability to utilize vendor financing and third-party leasing arrangements to fund capital expenditures in the future. MFC Management will continue to consider growth capital expenditures based on the economic merit of each project and the availability of funds.

***Currency Hedging Policy***

Medical Facilities USA is exposed to fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar because the distributions it receives from the MFC Partnerships are in U.S. dollars and the distributions that it makes to the Issuer are paid in Canadian dollars. In order to minimize the impact of fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar, Medical Facilities USA routinely enters into forward foreign exchange contracts generally for three year periods which provide for the conversion of specified U.S. dollar amounts into Canadian dollar amounts at monthly intervals. Medical Facilities USA intends to maintain an ongoing hedging policy in the future having regard to the volatility in the rates of exchange between the Canadian dollar and U.S. dollar at that time.

**Regulation**

***Licensing and Accreditation***

Healthcare facilities, such as the MFC Hospitals, are subject to numerous legal, regulatory, professional and private licensing, certification and accreditation requirements. These include, but are not limited to, requirements imposed by Medicare, Medicaid, State licensure, and private payor credentialing requirements. Renewal and continuation of certain of these licenses, certifications and accreditations are based on inspections, surveys, audits, investigations or other reviews, some of which may require affirmative compliance actions by the MFC Hospitals that could be burdensome and costly. Each of the MFC Hospitals holds all licences and accreditations necessary for its operation and the MFC Management does not anticipate any issues regarding their renewal.

***Stark Act***

The U.S. federal physician self-referral law, commonly referred to as the *Stark Act*, prohibits a physician from making a referral for certain "designated health services" to an entity if the physician or a member of the physician's immediate family has a financial relationship with the entity. A financial relationship is defined to include ownership or investment in, or a compensation relationship with, an entity. Under the original version of the

statute (Stark I) designated health services were limited to laboratory services. The statute was subsequently amended (Stark II) to expand the list of designated health services to include, among other services, inpatient and outpatient hospital services. The *Stark Act* also prohibits an entity receiving a prohibited referral from billing the Medicare or Medicaid programs for any services rendered to the patient. The *Stark Act* contains certain exceptions, which exempt certain financial arrangements from the *Stark Act's* prohibitions if the parties comply with the requirements of the exceptions. The sanctions under the *Stark Act* include denial and refund of payments, civil monetary penalties and exclusion from the Medicare and Medicaid programs. Additionally, violations of the *Stark Act* are potentially actionable under the federal *Civil False Claims Act* which permits government recoveries of treble damages and per-claim penalties up to $11,000.

Among the exceptions to the *Stark Act* are investments by physicians (or immediate family members) in a whole hospital if the referring physician is authorized to perform services at the hospital. The MFC Hospitals have relied on this exception as permitting their physician investors to refer patients to the MFC Hospitals.

On December 8, 2003, President Bush signed the *Medicare Prescription Drug, Improvement, and Modernization Act of 2003.* In addition to the comprehensive provisions regarding the Medicare program generally, the bill amended the *Stark Act* with respect to the hospital exception to the *Stark Act* described above (the "Amendment"). Specifically, for an 18 month period beginning November 18, 2003, the hospital exception was not available if the hospital was a "specialty hospital." Under the Amendment, a hospital was a "specialty hospital" if it was: (i) primarily or exclusively engaged in the care and treatment of the following categories of services: patients with a cardiac condition; patients with an orthopaedic condition; patients receiving a surgical procedure; and any other specialized category of services that the Secretary of Health and Human Services (the "Secretary") designates as inconsistent with the purpose of permitting physician ownership and investment interests in a hospital under the Amendment (the "Categories of Services"); and (ii) it was not subject to the "grandfather" provisions of the Amendment.

The grandfather provisions provided that a hospital was excluded from the definition of a "specialty hospital" if the hospital: (i) was determined by the Secretary to be in operation before November 18, 2003 or under development as of such date; (ii) for which the number of physician investors at any time on or after November 18, 2003 was no greater than the number of investors as of that date; (iii) for which the Categories of Services at the hospital were not different from the Categories of Services at the hospital on November 18, 2003; (iv) for which any increase in the number of beds occurred only on the main campus of the hospital and did not exceed the greater of 50% of the number of beds of the hospital on November 18, 2003, or five beds; and (v) met such other requirements as the Secretary may specify. To date, the Secretary has not specified any additional requirements.

The provision of *Medicare Prescription Drug, Improvement, and Modernization Act of 2003* regarding specialty hospitals expired on June 8, 2005. Shortly before expiration, Senator Charles Grassley (R. Iowa) and Senator Max Baucus (D. Mont.) introduced a bill entitled the "*Hospital Fair Competition Act of 2005.*" This bill attempted to permanently extend the moratorium on the development of new specialty hospitals. With regard to existing specialty hospitals, the bill imposed expanded grandfather language which prohibited existing specialty hospitals from: (1) increasing the percent of investment in the hospital by physician investors as a group beyond the percent of physician investment that existed on June 8, 2005; (2) increasing the percent of investment by any individual physician investor beyond the percent of investment by such physician that existed on June 8, 2005; (3) increasing the number of operating rooms beyond the number of operating rooms that existed at the specialty hospital on June 8, 2003; (4) increasing the number of beds beyond the number of beds that existed at the specialty hospital on June 8, 2005. The Hospital Fair Competition bill retained the provision in the *Medicare Prescription Drug, Improvement, and Modernization Act of 2003*, which prohibited existing specialty hospitals from adding categories of service that are different from the categories of service which existed at the hospital on November 18, 2003. The *Hospital Fair Competition Act of 2005*, if passed, would have been retroactive to June 8, 2005, meaning that there would be no legislative gap between the expiration of the provisions of the *Medicare Prescription Drug, Improvement, and Modernization Act of 2003* and the potential enactment of the *Hospital Fair Competition Act of 2005.*

In December of 2005, the language of the Hospital Fair Competition Act of 2005 relative to specialty hospitals was included in the Senate version of the Budget Reconciliation Act of 2005 which passed the Senate. However, during the same timeframe, the House of Representatives passed its own Budget Reconciliation package which contained no language restricting future or existing specialty hospitals. As a result of the disparity in

language between the Senate and House versions of the Budget Reconciliation Bills, the legislation went to a Conference Committee composed of members from both bodies who would attempt to reconcile the Bills. The Conference Committee crafted compromise legislation which extended the moratorium on approvals of new specialty hospitals for six (6) months. The Conference Committee, however, rejected inclusion of any of the language in the Hospital Fair Competition Act restricting existing specialty hospitals.

The legislation did require that a plan be developed to address the following issues regarding specialty hospitals: (1) proportionality of investment return; (2) bona fide investment; (3) annual disclosure of investment information; (4) the provision of care to patients who are eligible for medical assistance under Title XIX of the Social Security Act and Charity Care; and (5) appropriate enforcement. .

The revised language crafted by members of the Conference Committee passed both the House and Senate, was signed and became law.

As a result of the compromise language, the Center for Medicare Services (CMS) was charged with developing a strategic and implementing plan and addressing the above-issues identified by Congress. CMS completed its Final Report to Congress and Strategic and Implementing Plan under the Deficit Reduction Act of 2005 in August of 2006. In preparing its report, CMS conducted a survey of various hospitals including specialty hospitals.

The CMS survey found that based on the data received that investments in specialty hospitals was in fact *bona fide* and that return on investment received from investors in specialty hospitals proportional to investments, however, a number of specialty hospitals did not participate in the survey. The survey further found that specialty hospitals provided less Medicaid and charity care than general hospitals.

CMS also proposed a strategic and implementing plan for issues related to specialty hospitals. In part, CMS's strategic implementing plan contained the following: (1) a recommendation that the moratorium on the development of specialty hospitals not be continued; (2) a recommendation to refine the DRG payment system to make it more accurate and remove any financial incentives for specialty hospitals to treat less ill patients; (3) a recommendation to revise the payment system for Ambulatory Surgery Center (ASCs) to lessen the incentive for ASCs to convert to specialty hospitals; (4) a recommendation to authorize a demonstration "Gain Sharing Project" whereby hospitals and physicians could collaborate on cost saving measures and the physicians could receive some of the savings; (5) a recommendation to provide further guidance on what the expectations are for hospitals without emergency rooms regarding their appraisal, initial treatment, and transfer of patients with medical emergencies and a recommendation to revise the Emergency Medical Treatment and Active Labor Law (EMTALA) regulations to require that hospitals with specialized capabilities, including hospitals without emergency rooms, be required to accept transfers of unstable patients; (6) a recommendation that regulations require that all hospitals disclose investment and compensation arrangements with physicians to CMS; (7) a recommendation that hospitals disclose to patients whether a hospital is physician owned, and if so, the names of such physician owners; (8) a change in the provider enrollment forms to better distinguish between specialty hospitals and other hospitals; and (9) a recommendation that any suspected violations revealed by virtue of the reporting requirements for disclosure of investment and compensation arrangements be forwarded to the Office of Inspector General (OIG) for further investigation. CMS made no recommendations regarding charity care.

Currently, there is no moratorium on development future or existing specialty hospitals. CMS's above recommendations regarding specialty hospitals have not at this juncture been formally adopted into regulations binding on the specialty hospital industry, however, it is anticipated that they will be in the near future.

There can be no assurance that the Stark Act or other physician self-referral laws or regulations will not be amended, enacted or promulgated in the future that would prohibit or restrict ownership in the MFC Partnerships by physicians or referrals by the physician investors to the MFC Hospitals. If the physician investors in the MFC Partnerships are prohibited from making referrals to the MFC Hospitals, there will be a material adverse effect on the operations of the MFC Partnerships. In addition, there can be no assurance that investment in the MFC Partnerships by physicians will not be challenged by government enforcement agencies, or if challenged, that such structure and investments will be upheld by a court or administrative agency as not violating the Stark Act.

***Anti-Kickback Statute***

The *Federal Medicare/Medicaid Anti-Fraud and Abuse Amendments to the Social Security Act* (the "Anti-Kickback Statute") make it a criminal felony offence knowingly and wilfully to offer, pay, solicit or receive remuneration in order to induce business for which reimbursement is provided under the Medicare or Medicaid programs. In addition to criminal penalties, including fines of up to $25,000 and five years imprisonment, violations of the Anti-Kickback Statute can lead to civil monetary penalties and exclusion from Medicare, Medicaid and certain other state and federal healthcare programs. The scope of prohibited conduct in violation of the Anti-Kickback Statute is broad and includes economic arrangements involving hospitals, physicians and other healthcare providers, including joint ventures. There is limited case law interpreting the broad provisions of the Anti-Kickback Statute. In general, these decisions have held that if any purpose of a payment (including indirect remuneration) is intended to induce referrals, the payments made could be in violation of the statute, even if the payments also are intended as compensation for services actually rendered. Because of the uncertainty regarding the interpretation of the Anti- Kickback Statute and the possibility that it would make harmless (and even beneficial) conduct illegal, Congress mandated the promulgation of "safe harbour" regulations. The Office of the Inspector General of the Department of Health and Human Services has promulgated regulations, which describe certain "safe harbour" arrangements that will not be deemed to constitute violations of the Anti-Kickback Statute. Absolute compliance with all elements of a safe harbour means that the activity will be immune from prosecution under the Anti-Kickback Statute and may not serve as a basis for exclusion. An activity that fails to satisfy all elements of a safe harbour is not necessarily illegal, but the activity is not afforded immunity from prosecution or exclusion. The safe harbours described in the regulations are narrow and do not cover a wide range of economic relationships which many hospitals, physicians and other healthcare providers consider to be legitimate business arrangements not prohibited by the statute.

The MFC Partnerships are not currently in complete compliance with any safe harbour and Management anticipates that they will not satisfy all of the requirements of a safe harbour in the future. However, the MFC Partnerships are in substantial compliance with several elements of safe harbours that are available for physician owned ambulatory surgery centers and consistent with the requirement of several safe harbours that distributions to investing physicians be based on their relative ownership interests and not on their referrals. While Management believes that the MFC Partnerships would have substantial arguments in the event of a challenge alleging violations of the Anti-Kickback Statute, there is no guarantee that such allegations could not be successfully brought. The potential success of such allegations would be dependent on the facts and circumstances surrounding the MFC Hospitals and their operations. If the MFC Partnerships are challenged successfully under the Anti-Kickback Statute, the physician investors could be precluded from referring patients to the MFC Hospitals, resulting in termination of, or other adverse consequences to, the operations of the MFC Hospitals. In addition, the MFC Partnerships and their physician investors could be subject to sanctions, including loss of professional licenses, exclusion from the Medicare and Medicaid programs, and substantial fines and/or imprisonment. Additionally, there can be no assurance that other anti-kickback laws or regulations will not be enacted in the future that could have a material adverse effect on the MFC Partnerships.

***Patient Records and Confidentiality***

In 1996, Congress enacted the *Health Insurance Portability and Accountability Act* ("HIPAA"). HIPAA includes a number of "administrative simplification" provisions designed to: (i) streamline the electronic transmission of health claims; and (ii) protect the privacy and security of patient health information.

Although Congress did establish some requirements in HIPAA itself, it delegated authority to the Secretary of the United States Department of Health and Human Services (the "Secretary"), to develop and implement specific regulatory standards as well as to enforce those standards. The Secretary has promulgated regulations for the three major components of HIPAA's administrative simplification provisions, which are discussed in greater detail below.

***Administrative Requirements***

One major focus of HIPAA is in the area of electronic data interchange. Specifically, the regulations require all healthcare providers, healthcare clearinghouses and health plans who submit electronic transactions to do so in a nationally standardized format. The purpose is to allow for uniformity in claims and other electronic data communications between payors and providers. The regulations only apply to providers who submit claims

electronically. As part of the requirements, the Secretary has published implementation standards for providers to use when transmitting electronic data. The final date for the Administrative Requirements is May 23, 2007.

***Privacy Requirements***

Federal privacy regulations issued pursuant to HIPAA require health care providers (among other "covered entities" regulated by HIPAA) to protect the confidentiality of patient health information in any form, including electronically stored or transmitted information. Penalties for violation of the regulations range from civil fines to (in extreme circumstances involving intentional violations for financial gain) up to ten years imprisonment. In addition to requiring patient authorization for many uses and disclosures of health information, the HIPAA privacy regulations contain many administrative requirements designed to ensure that covered entities exercise prudent privacy practices. For example, HIPAA requires that covered entities: maintain detailed records of all disclosures of a patient's data, and make these records available to the patient upon his or her request; give patients the right to access, inspect, and request amendments to their health records; develop and adhere to strict privacy policies and furnish privacy notices to patients; provide privacy training for all employees; implement physical, technical, and administrative safeguards to prevent intentional or accidental misuse of health information; and designate a "privacy officer" to oversee implementation of these requirements. The compliance date for the Privacy Requirements was April 14, 2003.

***Security Requirements***

The HIPAA regulations also address the security of provider information. The requirements are directed to ensure that electronic health information pertaining to patients remains secure. The regulations require organizations to evaluate existing security and confidentiality policies, as well as technical practices and procedures, including access controls, audit trails, physical security and disaster recovery, protection of remote access points, protection of external electronic communications, and software and system assessment. The MFC Partnerships have incurred substantial costs to comply with these requirements. The compliance date for Security Requirements was April 20, 2005.

As of December 31, 2006, the MFC Partnerships were in compliance with the HIPAA. It is possible that compliance costs related to subsequently enacted transactions regulations would require the MFC Partnerships to make a further capital outlay. Moreover, any failure by the MFC Partnerships, their billing agents, and/or third party payors to comply with HIPAA requirements could result in substantial and possibly prolonged interruptions in the cash flow of the MFC Partnerships.

**Other Matters**

***Insurance***

Each MFC Partnership maintains medical professional liability insurance on a claims-made basis. Coverage under these policies is contingent upon the policy being in effect when a claim is made regardless of when the events that caused the claim occurred. Each MFC Partnership also maintains general liability and umbrella coverage on a claims-made basis. The cost and availability of such coverage has varied widely in recent years. Management believes that the insurance policies are adequate in amount and coverage for the operation of the surgical facilities, but there can be no assurance that the insurance coverage is sufficient to cover all future claims or that such insurance will continue to be available at a reasonable cost.

***Environmental Issues***

Each MFC Partnership's operations are subject to various federal, state and local laws and regulations relating to the protection of the environment and human health and safety. The operations of the MFC Partnerships include the use, generation and disposal of certain hazardous substances. Management believes that the operations of the MFC Partnerships have been in substantial compliance with the terms of applicable environmental laws and that no liabilities exist that could reasonably be expected to have a material adverse effect on the MFC Partnership's business or financial position. No MFC Partnership has reported any existing or potential environmental issues at any of the facilities, nor has it received any inquiry or notice that has resulted, or may reasonably be expected to result in, actual or potential proceedings, claims, lawsuits or losses related to environmental liabilities.

***Litigation***

Each MFC Partnership is involved in various litigation matters that occur in the ordinary course of business, none of which Management believes will have any material adverse effects on the financial and operating performance of the MFC Partnerships.

## THE ISSUER

**Description of IPSs**

As at December 31, 2006, there were 27,991,535 IPSs issued and outstanding after deducting the purchase of 20,000 IPSs pursuant to the normal course issuer bid. Each IPS represents: (a) one Common Share; and (b) Cdn$5.90 aggregate principal amount of 12.5% Subordinated Notes.

The ratio of Common Shares to principal amount of Subordinated Notes represented by an IPS is subject to change in the event of a stock split, recombination or reclassification, or upon a partial redemption or repurchase of the Subordinated Notes.

***Voluntary Separation and Recombination***

At any time after 90 days from the date of original issuance or upon the occurrence of a change of control of the Issuer, holders of IPSs may separate their IPSs into the Common Shares and Subordinated Notes represented thereby through their broker or other financial institution. Similarly, any holder of Common Shares and Subordinated Notes may recombine the applicable number of Common Shares and principal amount of Subordinated Notes to form IPSs through their broker or other financial institution, at any time.

***Automatic Separation***

Upon the occurrence of any of the following, the IPSs will be automatically separated into the Common Shares and Subordinated Notes represented thereby:

- with respect to any holder of IPSs, acceptance by such holder of the Issuer's offer to repurchase the Subordinated Notes represented by that holder's IPSs in connection with a change of control of the Issuer;
- exercise by the Issuer of its right to redeem all or a portion of the Subordinated Notes, which may be represented by IPSs at the time of such redemption;
- the date on which the principal amount outstanding on the Subordinated Notes becomes due and payable, whether at the stated maturity date or upon acceleration thereof; or
- if CDS is unwilling or unable to continue as securities depository with respect to the IPSs and the Issuer is unable to find a successor depository.

**Book-Entry Settlement and Clearance**

CDS acts as securities depository for the IPSs, and the Subordinated Notes and Common Shares represented by the IPSs, which are referred to collectively as the "Securities." The IPSs and the Subordinated Notes and Common Shares represented by the IPSs are represented by one or more global notes and global stock certificates. The global notes and global stock certificates have been issued in fully-registered book-entry only form in the name of CDS or its nominee, CDS & Co. If an investor intends to purchase IPSs, an investor must do so through direct and indirect CDS participants. The participant through which a purchase is made will receive a credit for the applicable number of Securities on CDS's records. The ownership interest of each actual purchaser of the applicable security, referred to as a "beneficial owner," is to be recorded on the participant's records. Beneficial owners will not receive written confirmation from CDS of their purchases, but beneficial owners are expected to

receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the CDS participant through which the beneficial owner entered into the transaction.

All interests in the Securities will be subject to the operations and procedures of CDS. The following is a summary of those operations and is provided by the Issuer solely for convenience. The operations and procedures of each settlement system may be changed at any time. The Issuer is not responsible for those operations and procedures.

To facilitate subsequent transfers, all Securities deposited by direct CDS participants are registered in the name of CDS. The deposit of Securities with CDS and their registration in the name of CDS effect no change in beneficial ownership. CDS has no knowledge of the actual beneficial owners of the Securities. CDS's records reflect only the identity of the direct CDS participants to whose accounts such Securities are credited, which may or may not be the beneficial owners. The CDS participants will remain responsible for keeping account of their holdings on behalf of their customers.

Transfers of ownership interests in the securities are effected by entries made on the books of the CDS participants acting on behalf of beneficial owners. Beneficial owners will not receive certificates representing their ownership interests in the applicable security except in the event that use of the book-entry only system for the securities is discontinued.

Cross-market transfers between CDS participants, on the one hand, and the Depositary Trust Company ("DTC") participants, on the other hand, will be effected within CDS through DTC. To deliver or receive an interest in securities held in a DTC account, an investor must send transfer instructions to DTC under the rules and procedures of that system and within the established deadlines of that system. If the transaction meets its settlement requirements, DTC will send instructions to its CDS depositary to take action to effect final settlement by delivering or receiving interests in the securities in CDS and making or receiving payment under normal procedures for same-day funds settlement applicable to CDS. DTC participants may not deliver instructions directly to the CDS depositary that is acting for DTC.

*Separation and recombination.* Any voluntary or automatic separation of IPSs and any subsequent recombination of IPSs from Subordinated Notes and Common Shares, are to be accomplished by entries made by the CDS participants on behalf of beneficial owners. In any such case, the participant's account through which a separation or recombination is effected, will be credited and debited for the applicable securities on CDS's records.

Conveyance of notices and other communications by CDS to direct participants, by direct participants to indirect CDS participants, and by CDS participants to beneficial owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

CDS will not consent or vote with respect to the securities. Under its usual procedures, CDS would mail an omnibus proxy to the Issuer as soon as possible after the record date. The omnibus proxy assigns CDS's consent or voting rights to those direct participants to whose accounts the Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

The Issuer and the Trustee under the Subordinated Note indenture will make any payments on the Common Shares and Subordinated Notes to CDS. CDS's practice is to credit direct CDS participants' accounts on the payment date in accordance with their respective holdings shown on CDS's records unless CDS has reason to believe that it will not receive payment on the payment date. Payments by CDS participants to beneficial owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such participant and not of CDS, the Issuer or the trustee, subject to any statutory or regulatory requirements as may be in effect from time to time.

The Issuer and the Trustee under the Subordinated Note indenture will be responsible for the payment of all amounts to CDS. CDS will be responsible for the disbursement of those payments to its participants, and the participants will be responsible for disbursements of those payments to beneficial owners.

CDS may discontinue providing its service as securities depository with respect to the IPSs, the Common Shares or the Subordinated Notes at any time by giving reasonable notice to the Issuer and the Trustee under the Subordinated Note indenture. If CDS discontinues providing its service as securities depository with respect to the IPSs and the Issuer is unable to obtain a successor securities depository, an investor will automatically take a position in the component securities and the Issuer will print and deliver certificates representing the IPSs. If CDS discontinues providing its service as securities depository with respect to the Common Shares or Subordinated Notes and the Issuer is unable to obtain a successor securities depository, the Issuer will print and deliver to the investor certificates for those securities and the investor will automatically take a position in the securities and the Issuer will print and deliver certificates for the Common Shares and Subordinated Notes.

Also, in the event that the Issuer decides to discontinue use of the system of book-entry only transfers through CDS (or a successor securities depository) the Issuer will print and deliver to the investor certificates for the Common Shares and Subordinated Notes the investor may own.

The information in this section concerning CDS and CDS' book-entry only system has been obtained from sources that the Issuer believes to be reliable, including CDS, but the Issuer takes no responsibility for its accuracy.

Neither the Issuer nor any director, nor the underwriters will have any responsibility or obligation to participants, or the persons for whom they act as nominees, with respect to:

- the accuracy of the records of CDS, its nominee, or any participant, any ownership interest in the securities, or
- any payments to, or the providing of notice, to participants or beneficial owners.

*Procedures relating to subsequent issuances.* The indenture governing the Subordinated Notes and the agreements with CDS provides that, in the event there is a subsequent issuance of Subordinated Notes, the terms of the newly issued Subordinated Notes (including interest and maturity) will be identical in all material respects to the previously issued Subordinated Notes and all such Subordinated Notes will be traded under the same CUSIP number. Any such subsequently issued Subordinated Notes may be issued at a discount or premium to the principal amount of Subordinated offered in the IPO.

**Share Capital of the Issuer**

The authorized share capital of the Issuer consists of an unlimited number of Common Shares. As at December 31, 2006, all of the issued and outstanding Common Shares are represented by IPSs.

Holders of Common Shares are entitled to receive dividends as and when declared by the board of directors and are entitled to one vote per Common Share on all matters to be voted on at all meetings of shareholders. Upon the voluntary or involuntary liquidation, dissolution or winding-up of Issuer, the holders of Common Shares are entitled to share rateably in the remaining assets available for distribution, after payment of liabilities.

**Description Of Subordinated Notes**

As at December 31, 2006, Cdn$165,150,056 principal amount of Subordinated Note were outstanding after deducting the purchase of 20,000 IPSs pursuant to the normal course issuer bid. The Subordinated Notes have been issued under the Indenture between the Issuer and the Trustee. The following is a brief summary of the terms of the Indenture and is subject to, and qualified in its entirety by, all of the provisions of the Indenture, which is specifically incorporated by reference herein. A copy of the Indenture is available on SEDAR at www.sedar.com.

***Market***

In certain circumstances, the Subordinated Notes and Common Shares represented by the IPSs will separate. There is no market through which such Subordinated Notes may be sold and holders of such Subordinated Notes may not be able to resell them.

***Interest Rate***

The interest rate on the Subordinated Notes is 12.5% per annum.

***Record and Payment Dates***

Interest is paid monthly in arrears on the 15th day of each month (or the next Business Day if such day is not a Business Day) (the first Business Day after May 15), to holders of record on the last Business Day of the preceding month.

***Principal Repayment***

The Subordinated Notes provide for the payment of interest only until the end of the term of the Subordinated Notes, at which time the principal balance will be payable by the Issuer.

***Maturity Date***

The Subordinated Notes will mature on March 29, 2014. The Issuer may extend the maturity of the Subordinated Notes for two additional successive five-year terms provided that certain conditions are satisfied.

***Optional Redemption***

On or after the fifth anniversary of the Closing, the Issuer may redeem the Subordinated Notes, at its option, at any time in whole and from time to time in part, upon not less than 30 nor more than 60 days notice, for cash, at a redemption price equal to: (i) 105% of the principal amount of Subordinated Notes being redeemed where the redemption occurs on or after the fifth anniversary but before the sixth anniversary of the Closing; (ii) 104% of such amount where the redemption occurs on or after the sixth anniversary but before the seventh anniversary of the Closing; (iii) 103% of such amount where the redemption occurs on or after the seventh anniversary but before the eighth anniversary of the Closing; (iv) 102% of such amount where the redemption occurs on or after the eighth anniversary but before the ninth anniversary of the Closing; (v) 101% of such amount where the redemption occurs on or after the ninth anniversary but before the tenth anniversary; and (vi) 100% of such amount on maturity. Any exercise by the Issuer of its option to redeem Subordinated Notes, in whole or in part, will result in an automatic separation of the IPS into a Common Share and Subordinated Notes.

***Change of Control***

Upon the occurrence of a change of control, the Issuer will be required to make an offer to each holder of Subordinated Notes to repurchase that holder's Subordinated Notes at a price equal to 101% of the principal amount of the Subordinated Notes being repurchased, plus any accrued but unpaid interest to the date of repurchase. However, a holder of IPSs will not be able to have its Subordinated Notes repurchased unless such holder surrenders the IPSs to the depositary, and receives delivery of the underlying Common Shares and Subordinated Notes.

***Subco Notes and Subco Guarantees***

Upon Closing, each Holding Entity transferred 100% of its partnership interests (49% of each MFC Partnership) in its related MFC Partnership to its related Subco in consideration for 100% of the membership interests in the Subco and the delivery of subordinated notes of Subco (the "Subco Notes"). The material terms of the Subco Notes are substantially similar to the Subordinated Notes with the rate, term and default provisions, as applicable, being identical. The initial aggregate principal amount of all Subco Notes is equal to 96.08% of the initial aggregate principal amount of the Subordinated Notes, to reflect the initial 49:51 ownership ratio, which proportion will adjust upon any exchanges of Exchangeable Interests for IPSs. Each MFC Partnership has provided a limited cash flow guarantee ("Subco Guarantee") of its related Subco's cash flow obligations on the Subco Notes to the same extent and subject to the same limitations as the Subordinated Note Guarantees. The Subco Guarantees are not a guarantee of the repayment of principal of the Subco Notes.

***Security and Subordinated Note Guarantees***

The Subordinated Notes are secured by a pledge of the Issuer's membership interests in Medical Facilities USA and unconditionally guaranteed by Medical Facilities USA, which guarantee is secured by a pledge of Medical Facilities USA's interests in each MFC Partnership.

The Subordinated Notes are also supported by a limited cash flow guarantee provided by each MFC Partnership (the "Subordinated Note Guarantees"), subject to certain limitations. The Subordinated Note Guarantees are not a guarantee of the repayment of principal of the Subordinated Notes.

The amount of the guarantee under the Subordinated Note Guarantees and Subco Guarantees will not be increased by the issuance of additional IPSs other than as a result of an exchange of Exchangeable Interests in respect of an MFC Partnership, in which case the amount of the related Subco Guarantee will be reduced proportionately and the Subordinate Note Guarantee will be increased proportionately to reflect the proportionate increase in Medical Facilities USA's partnership interest in such MFC Partnership.

***Ranking***

The Subordinated Notes are secured senior subordinated indebtedness of the Issuer and are subordinated in right of payment, as set forth in the Indenture, to all existing and future secured senior indebtedness of the Issuer but will rank senior to all unsecured indebtedness of the Issuer. Because the Issuer is a holding company and conducts no independent operations, the Subordinated Notes are structurally subordinate to the obligations of the Issuer's subsidiaries (other than Medical Facilities USA), including the MFC Partnerships (except for the holders' rights and remedies under the Subordinated Note Guarantees which in prescribed circumstances will effectively result in the right to interest payments on the Subordinated Notes ranking *pari passu* with all unsecured indebtedness of the MFC Partnerships).

***Restrictive Covenants***

The Indenture contains the following covenants with respect to the Issuer that restrict:

- the incurrence of additional indebtedness;
- the payment of dividends on, and repurchase of, Common Shares;
- a number of other restricted payments, including investments;
- specified sales of assets;
- specified transactions with affiliates;
- the creation of a number of liens; and
- consolidations, mergers and transfers of all or substantially all of the Issuer's assets.

The limitations and prohibitions described above are subject to a number of important qualifications and exceptions. For a more detailed description, please refer to the Indenture available on SEDAR at www.sedar.com.

**Limitations on U.S. Licensed Physician Ownership**

***General***

Previously, the *Stark Act* prohibited the MFC Partnerships (as owners of MFC Hospitals) from having investors who are physicians who refer to an MFC Hospital (or family members thereof) but who are not authorized to perform services at the hospital.

***Shareholdings***

Due to previous requirements (which no longer apply) that capped the number of physician owners of a specialty hospital, and uncertainty regarding the interpretation of the *Stark Act* and whether or not a physician investor holding an interest in the IPSs or Common Shares constitutes a physician investor in any of the MFC Partnerships, the Issuer adopted restrictions in its articles that restricted any physician licensed to practice in the U.S. (or any immediate family member thereof) from owning IPSs or Common Shares. The articles of the Issuer provide the Issuer's directors with the authority to prohibit the issue or transfer of the IPSs and Common Shares to any person who is a physician licensed to practice in the U.S. (or an immediate family member) that might result in a violation of the *Stark Act*. An immediate family member is defined to mean husband or wife; natural or adoptive parent, child, or sibling stepparent; stepchild, stepbrother, or stepsister; father-in-law, mother-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law; grandparent or grandchild; and spouse of a grandparent or grandchild. Because of the dynamic nature of health law in the United States, and the importance of compliance, the Issuer has determined to retain the above-described restriction on transferability

The articles of the Issuer also provided that, before an issue or transfer of IPSs, Common Shares or any other security is recorded on the register of the Issuer, the purchaser or transferee, as the case may be, may be required to submit to the Issuer or its agents a declaration as to its beneficial ownership of such securities, its citizenship and occupation and such other matters as the board of directors of the Issuer could deem relevant in order to determine whether the registration of the purchaser or transferee should be prohibited. Such a declaration could also be required at any time when proxies are being solicited from shareholders or noteholders, before or at any meeting of shareholders or at any time when, in the opinion of the board of directors of the Issuer, the holding of IPSs or Common Shares by any person who is a licensed physician in the U.S. (or an immediate family member) should be prohibited. Shareholders of the Issuer are accordingly restricted from selling their IPSs or Common Shares to any person who is a physician licensed to practice in the U.S. (or an immediate family member) which might result in a violation of the *Stark Act*.

Notwithstanding the foregoing, if the board of directors determines that a physician licensed to practice in the U.S. (or an immediate family member) holds IPSs or Common Shares which might result in a violation of the *Stark Act*, the board of directors may send a notice requiring such holder to sell the beneficial interest in the securities to persons who are not physicians licensed to practice in the U.S. (or an immediate family member) within a specified period of not less than 10 days. If a beneficial owner of IPSs or Common Shares receiving such notice has not sold the specified securities or provided the board of directors with satisfactory evidence that the holder is not a physician licensed to practice in the U.S. (or an immediate family member) within such period, the board of directors may, on behalf of such beneficial owner sell such securities and, in the interim, will suspend the voting and distribution rights attached to such securities. Upon such sale, the affected beneficial owner of IPSs or Common Shares will cease to be the beneficial owner of such securities and his or her rights will be limited to receiving the net proceeds of such sale. The board of directors would have had no liability for the amount received upon such sale provided that they act in good faith.

***Subordinated Notes***

The Indenture contains substantively identical provisions concerning the Subordinated Notes as described above under "Shareholdings", including the right to compel a physician licensed to practice in the U.S. (or an immediate family member) to dispose of the Subordinated Notes.

**Removal of Limitation on U.S. Resident Ownership**

In order to ensure that the Issuer was exempt from the registration requirements as an investment company under the *Investment Companies Act of 1940* (the "1940 Act"), the Issuer introduced the restriction that at no time may more than 100 U.S. persons (using the principles of counting for purposes of Section 3(c)(1) of the 1940 Act) be the beneficial owners of the IPSs, the Subordinated Notes or the Common Shares, nor may any U.S. person be the beneficial owner of more than 10% of the IPSs, the Subordinated Notes or the Common Shares (the "Ownership Restriction").

In fiscal 2005, the Issuer was advised by counsel that it was unlikely that the removal of the Ownership Restriction would cause the Issuer to become subject to the registration requirements as an investment company

under the 1940 Act. Based on this analysis, management was of the view that amending the company's articles of continuance to remove the Ownership Restriction would be advantageous to the Issuer. On May 12, 2006, at the Issuer's annual and special meeting of securityholders, the removal of these restrictions was unanimously approved.

**Distribution Policy**

The Issuer pays interest on the Subordinated Notes and dividends on the Common Shares (if declared) on the 15th day of each month (or the next Business Day, if such day is not a Business Day) to holders of record at the close of business on the last Business Day of the preceding month. The distributions consist of:

- dividends on the Common Share represented by an IPS, if and to the extent dividends are declared by the Issuer's board of directors and permitted by applicable law. The Issuer has currently adopted a dividend policy that contemplates an annual dividend of approximately Cdn$0.3625 per IPS;

after:

- making interest payments at an annual rate of 12.5% of the aggregate principal amount of the Subordinated Notes represented by an IPS or approximately Cdn$0.7380 per IPS per year;
- satisfying its debt service obligations under any credit facilities or other agreements with third parties, if any;
- satisfying its other expense obligations, including withholding and other applicable taxes; and
- retaining reasonable reserves for working capital and other expenses.

The Issuer may make additional distributions in excess of monthly distributions during the year, as the board of directors may determine in its sole discretion.

The Subordinated Note indenture contains restrictions on the ability of the Issuer to declare and pay dividends on the Common Shares. The board of directors of the Issuer may, in its discretion, modify or repeal the Issuer's current dividend policy. No assurances can be made that the Issuer will pay dividends at the level contemplated in the future or at all. Assuming that the Issuer makes the scheduled interest payments on the Subordinated Notes and pays dividends on the Common Shares in the amount contemplated by the current dividend policy, an investor would receive, in the aggregate, approximately Cdn$1.10 per year per IPS in dividends on the Common Shares and interest on the Subordinated Notes.

***Distributions paid to IPS Holders***

Distributions of Cdn$0.0917 were paid on the 15th day of each month of 2006 (or the next Business Day, if such day was not a Business Day) to holders of record at the close of business on the last Business Day of the preceding month. Total distributions for 2006 were as follows:

| Record Date | Dividend Per Common Share (Cdn$) | Interest Payment on Subordinated Note (Cdn$) | Total Distribution Per IPS (Cdn$) |
|---|---|---|---|
| January 31 | 0.0302 | 0.0615 | 0.0917 |
| February 28 | 0.0302 | 0.0615 | 0.0917 |
| March 31 | 0.0302 | 0.0615 | 0.0917 |
| April 28 | 0.0302 | 0.0715 | 0.0917 |
| May 31 | 0.0302 | 0.0615 | 0.0917 |
| June 30 | 0.0302 | 0.0615 | 0.0917 |
| July 31 | 0.0302 | 0.0615 | 0.0917 |
| August 31 | 0.0302 | 0.0615 | 0.0917 |
| September 29 | 0.0302 | 0.0615 | 0.0917 |
| October 31 | 0.0302 | 0.0615 | 0.0917 |

| Record Date | Dividend Per Common Share (Cdn$) | Interest Payment on Subordinated Note (Cdn$) | Total Distribution Per IPS (Cdn$) |
|---|---|---|---|
| November 30 | 0.0302 | 0.0615 | 0.0917 |
| December 29 | 0.0302 | 0.0615 | 0.0917 |
| Total 2006 Distributions | 0.3624 | 0.7380 | 1.1004 |

In fiscal 2005, distributions of Cdn$0.0917 were paid on the 15th day of each month (or the next Business Day, if such day was not a Business Day) to holders of record at the close of business on the last Business Day of the preceding month. Total distributions for 2005 were as follows:

| Record Date | Dividend Per Common Share (Cdn$) | Interest Payment on Subordinated Note (Cdn$) | Total Distribution Per IPS (Cdn$) |
|---|---|---|---|
| January 31 | 0.0302 | 0.0615 | 0.0917 |
| February 28 | 0.0302 | 0.0615 | 0.0917 |
| March 31 | 0.0302 | 0.0615 | 0.0917 |
| April 28 | 0.0302 | 0.0715 | 0.0917 |
| May 31 | 0.0302 | 0.0615 | 0.0917 |
| June 30 | 0.0302 | 0.0615 | 0.0917 |
| July 31 | 0.0302 | 0.0615 | 0.0917 |
| August 31 | 0.0302 | 0.0615 | 0.0917 |
| September 29 | 0.0302 | 0.0615 | 0.0917 |
| October 31 | 0.0302 | 0.0615 | 0.0917 |
| November 30 | 0.0302 | 0.0615 | 0.0917 |
| December 31 | 0.0302 | 0.0615 | 0.0917 |
| Total 2005 Distributions | 0.3624 | 0.7380 | 1.1004 |

**Administration**

The issuer directly administers its reporting and other public issuer obligations, with assistance from Medical Facilities USA, as required. A portion of the costs of such obligations for each year, which portion will reduce proportionately as Exchangeable Interest are exchanged and which will in no event exceed $392,000 per annum (in the aggregate), are borne by the Holding Entities (through reduced distributions to the Subcos on the Retained Interest) based on the Subcos' ownership interest in the MFC Partnerships determined on a fully diluted Bases. The Issuer is responsible for the first $350,000 in each year and any obligations that exceed the maximum $392,000 obligation of the Holding Entities.

**Dividend Reinvestment Plan**

The board of directors of the Issuer has approved and is in the process of implementing a Dividend Reinvestment and Unit Purchase Plan (the "DRIP"). The DRIP provides a means for participants to invest all distributions on IPSs into additional IPSs of the Issuer. IPSs will be purchased by Computershare Investor Services Inc. on the open market through the Toronto Stock Exchange.

## MEDICAL FACILITIES USA

### Capital of Medical Facilities USA

The authorized capital of Medical Facilities USA consists of an unlimited number of membership interests. As at December 31, 2006, 100% of the outstanding membership interests of Medical Facilities USA were owned by the Issuer.

The membership interests carry one vote per interest on all matters to be voted on at all meetings of members. Holders of membership interests are entitled to receive distributions as and when declared by the board of managers. Upon the voluntary or involuntary liquidation, dissolution or winding-up of Medical Facilities USA, the holders of membership interests are entitled to share rateably in the remaining assets available for distribution, after payment of liabilities.

### Distribution Policy

The board of managers of Medical Facilities USA has adopted a dividend policy pursuant to which Medical Facilities USA will distribute its available cash to the maximum extent possible, subject to applicable law, by way of monthly distributions on its membership interests or other distributions on its securities after:

- satisfying its debt service obligations under any credit facilities or other agreements with third parties, if any; and
- satisfying its other expense obligations, including administration expenses, and withholding and other applicable taxes.

### Operating Agreement

The Issuer, Medical Facilities USA and each Original Subco entered into the Operating Agreement upon Closing of the IPO with respect to operations and affairs of Medical Facilities USA. The following is a summary of certain provisions of the Medical Facilities USA Operating Agreement, which summary is not intended to be complete. Reference is made to the Medical Facilities USA Operating Agreement for a complete description and the full text of its provisions.

#### *Managers*

The Operating Agreement provides for a board of managers consisting of eleven managers of Medical Facilities USA. A majority of the managers must be U.S residents. All representatives of the MFC Partnerships must be US residents. The board of managers of Medical Facilities USA is currently comprised of a majority of managers unrelated to Medical Facilities USA and the MFC Partnerships, as follows:

- six representatives of the Issuer (five directors of the Issuer and one independent US resident); and
- five representatives of the MFC Original Partnerships, specifically two representatives of Black Hills; two representatives of Sioux Falls and one representative of Dakota Plans.

The board representatives rights of the MFC Original Partnerships will be adjusted as the Original Subcos' aggregate ownership of IPSs on a Full Diluted Basis is reduced. "Fully Diluted Basis" means the proportion that the Retained Interests represent of the outstanding IPSs from time to time on a fully exchanged basis assuming for such purpose that the Continuing Interests are exchangeable on the same basis as the Exchangeable Interests. The MFC Partnerships' board representation rights will be adjusted as follows (provided that the MFC Partnerships may agree to adjust their board representation rights as between themselves to reflect changes in their respective ownership):

| Ownership on Fully Diluted Basis | Board Representation Rights |
|---|---|
| More than or equal to 20% | 5 representatives, 2 from each of Black Hills and Sioux Falls, and one from Dakota Plains |
| Less than 20% but not less than 15% | 3 representatives, one from each MFC Partnership |
| Less than 15% but not less than 10% | 2 representatives, one from each of Black Hills and Sioux Falls |
| Less than 10% | No representative |

***Special Approvals***

In addition to majority approval of the board of managers of Medical Facilities USA, for so long as the MFC Partnerships' aggregate Retained Interests constitute not less than 20% of the IPSs on a Fully Diluted Basis, the approval of not less than four of the MFC Partnerships' representatives on the board of managers of Medical Facilities USA will be required for Medical Facilities USA to: (i) other than in connection with an event of default under the Indenture or at any time following a realization by the holders of Subordinated Notes of the security granted by Medical Facilities USA in support of the Subordinated Notes, enter into a merger, consolidation, combination or other material transaction of a similar nature; (ii) other than in connection with an event of default under the Indenture or at any time following a realization by the holders of Subordinated Notes of the security granted by Medical Facilities USA in support of the Subordinated Notes, directly or indirectly sell or otherwise dispose of all or substantially all of its assets; (iii) adopt any plan or proposal for the liquidating, dissolving, reorganizing or recapitalizing of Medical Facilities USA or to commence any action seeking relief under any laws relating to bankruptcy, insolvency, conservatorship or relief of debtors; (iv) enter into lines of business (not including new lines of procedures) other than those currently carried on; (v) change its fiscal year (unless required or indicated for tax reasons) or make a material change in its accounting policies or procedures unless required under the applicable generally accepted accounting principles; (vi) take, or permit, any action which would prevent the business from continuing on an ongoing basis; or (vii) agree to do any of the preceding. Subject to the foregoing, such approval of the representatives of the MFC Partnerships is not required for issuances of securities of, or acquisitions by, Medical Facilities USA.

***Executive***

The managers have the exclusive authority to manage the business and affairs of Medical Facilities USA, to make all decisions regarding Medical Facilities USA and to bind Medical Facilities USA. The managers have appointed a chief executive officer, a president and a chief financial officer. Day-to-day responsibility for the public issuer obligations of the Issuer have been delegated to the Medical Facilities USA executive (financial reporting, timely and continuous disclosure, etc.).

***Amendment***

The Operating Agreement provides that it can only be amended, modified or waived with the approval of the Issuer, Medical Facilities USA and each Original Subco.

***Acquisition Committee***

The board of managers of Medical Facilities USA has an acquisition committee comprised of the following individuals: Irving Gerstein (Chair), Dr. Donald Schellpfeffer, Seymour Temkin, Dr. Larry Teuber and Michael Salter, Chief Financial Officer of Medical Facilities USA. This committee is responsible for the oversight and guidance of Medical Facilities USA's acquisition process as well as the review of potential acquisition targets and recommendations to the Board regarding same.

## THE MFC PARTNERSHIPS

### Capital of the MFC Partnerships

Medical Facilities USA owns the partnership interest in each MFC Partnership and the Existing Partners of each MFC Partnership owns the partnership interest in its respective MFC Partnership as set out in the chart below.

| MFC Partnership | Subco Interest | Medical Facilities USA Interest |
|---|---|---|
| Sioux Falls | 49% | 51% |
| Black Hills | 47.05% | 52.95% |
| Dakota Plains | 49% | 51% |
| OSH | 49% | 51% |

The partnership interests carry such number of votes equal to the partnership interest on all matters to be voted on at all meetings of partners. Holders of partnership interests are entitled to their pro rata distribution equivalent to their partnership interest as and when declared by the management committee of the MFC Partnership. Upon the voluntary or involuntary liquidation, dissolution or winding-up of a MFC Partnership, the holders of partnership interests will be entitled to share rateably in the remaining assets available for distribution, after payment of all liabilities.

### Distribution Policy

The management committee of each MFC Partnership has adopted a policy that each MFC Partnership will distribute its available cash to the maximum extent possible, subject to applicable law and to compliance with their existing credit facilities, by way of monthly distributions on its partnership interests or other distributions on its securities, after:

- satisfying its debt service obligations under its Credit Facility or any other credit facilities or any other agreements with third parties;
- satisfying its other expense obligations, including withholding and other applicable taxes; and
- retaining reasonable working capital or other reserves, including amounts on account of capital expenditures and such other amounts as may be considered appropriate by its management committee, subject to Medical Facilities USA's prior approval in certain circumstances.

Capital expenditures of each MFC Partnership and other expenditures may be financed:

- by borrowings under its credit facilities;
- by additional issuances of securities to Medical Facilities USA and/or its related Subco;
- from the working capital and cash flow of the business; and/or
- by seller and vendor financing or other third party borrowings.

Subject to certain limitations and exceptions, each MFC Partnership, and the MFC Partnerships as a group, will be limited as to the amount of liabilities which may be incurred.

### Partnership Agreements

The following is a summary of certain provisions of the Partnership Agreements, each entered into by Medical Facilities USA, an MFC Partnership and its respective Subco, which summary is not intended to be

complete. Each Partnership Agreement has substantially similar terms. Reference is made to each Partnership Agreement for a complete description and the full text of its provisions.

***Managers***

The management committee of each MFC Partnership is comprised of persons elected by the board of managers of the affiliated Subco and one representative of Medical Facilities USA designated by the Issuer representatives on the Medical Facilities USA board of managers. Executive management is determined for each MFC Partnership by its management committee.

***Budget***

Each MFC Partnership is responsible for preparing a budget for the following fiscal year by October 31 of each year, addressing projected revenue, expenditure and distributions. Any such budget which (i) reflects a material change (increase of 15% or more) in capital expenditures, reserves, debt or debt service obligations or significant expense items (specifically labour, overhead or any other expenses item representing more than 15% of revenue), (ii) contemplates a reduction in distributions over the previous year, or (iii) contemplates the incurrence of any extraordinary or non-recurring items will be subject to approval of the Medical Facilities USA board of managers. In the event that the MFC Partnership and Medical Facilities USA do not agree on a proposed budget, Medical Facilities USA will be entitled to establish the budget for the MFC Partnership.

***Fundamental Decisions***

For each MFC Partnership, (i) any expenditure deviations from the budget for the then current year in an aggregate amount exceeding the lesser of (A) CPI plus 5% of budgeted cash flow (calculated in a prescribed manner) for the then current fiscal year; and (B) $1.5 million; (ii) any reduction in distributions from budgeted amounts, and for each MFC Original Partnership (iii) any incurrence of indebtedness which would cause the MFC Partnerships alone, or the MFC Partnerships in the aggregate, to exceed certain limitations will be subject to approval of the Medical Facilities USA board of managers. In addition, the following fundamental transactions on the part of the MFC Partnerships will be subject to the approval of the Medical Facilities USA board of managers: (i) entering into a merger, consolidation, combination or other material transaction of that nature; (ii) directly or indirectly selling or otherwise disposing of all or substantially all of its assets; (iii) adopting any plan or proposal for the liquidating, dissolving, reorganizing or recapitalizing the MFC Partnership or commencing any action seeking relief under any laws relating to bankruptcy, insolvency, conservatorship or relief of debtors; (iv) consummating an acquisition or acquisitions or entering into contracts (other than payor contracts or those relating to capital expenditures contemplated in the budget which would result in expenditures in excess of certain prescribed limits; (v) entering into lines of business other than those currently carried on (not including new lines of surgery); (vi) changing its fiscal year or making a material change in its accounting policies or procedures unless required under the applicable generally accepted accounting principles; (vii) taking, or permitting, any action which would prevent the business from continuing on an ongoing basis; (viii) issuing, redeeming, purchasing, transferring or agreeing to the transfer of any partnership interests (subject to rights of exchange of the Exchangeable Interests); (ix) a substantive change to the MFC Partnership's distribution policy; (x) entering into material transactions outside of the normal course of business; or (xi) agreeing to do any of the preceding. The incurrence of indebtedness or liens in excess of $500,000 in a twelve-month period (other than indebtedness to fund distributions) on the part of the MFC Original Partnership's and any amendment to the lease arrangements with Memorial Property Holdings LLC on the part of the Spine Hospital also require the approval of the Medical Facilities USA board of managers. The numerical thresholds will adjust annually based on the CPI.

***Limitation on Liabilities***

The MFC Partnerships are prohibited from exceeding, without the consent of Medical Facilities USA, aggregate liabilities incurred in the ordinary course, other than excluded liabilities, of $5 million in respect of Black Hills, Sioux Falls and OSH and $2 million in respect of Dakota Plains. The definition "excluded liabilities" includes: any secured indebtedness of the MFC Partnership existing as at March 29, 2004 for the MFC Original Partnerships and as at June 21, 2005 for the Spine Hospital including liabilities arising from or relating to the Subordinated Note Guarantees and/or the Subco Guarantees; the OSH Subordinate Note Guarantee and/or the OSH Subco Guarantee; any indebtedness incurred in the ordinary course secured by the MFC Partnership's accounts

receivables and/or inventory; capital equipment financing secured by the equipment; and any fixed asset mortgages incurred in the ordinary course. Identical prohibitions are contained in each Subordinated Note Guarantee and Subco Guarantee as well as the OSH Subordinate Note Guarantee and the OSH Subco Guarantee.

***Ownership Restrictions***

Each Subco is prohibited from selling or transferring its Retained Interest (other than exchanges of the Exchangeable Interest) in the applicable MFC Partnership without the approval of the board of managers of Medical Facilities USA.

***Senior Management of MFC Partnerships***

The board of managers of Medical Facilities USA has the right to terminate any member of senior management of any of the MFC Partnerships if such officer is not terminated by the respective MFC Partnership in circumstances where (i) the officer has engaged in conduct which is fraudulent or grossly negligent, (ii) the officer has participated in or acquiesced to a material breach of the MFC Partnership's non-financial (including reporting) obligations to Medical Facilities USA, or (iii) the MFC Partnership for a given year materially underperforms its budget (other than a budget imposed by Medical Facilities USA unless such budget has been determined by an independent qualified arbiter to have been reasonably attainable) and such underperformance is in the reasonable opinion of the Medical Facilities USA board, attributable in material part to the officer's performance.

***Reporting***

Each MFC Partnership provides monthly financial reporting to Medical Facilities USA in such manner as Medical Facilities USA may reasonably request to support for: (i) Medical Facilities USA's discharge of its responsibility for the Issuer's financial disclosure requirements (including the Issuer's reporting requirements under the Indenture); and (ii) Medical Facilities USA's monitoring of budget compliance.

***Management Services***

Arrangements pursuant to which management services are provided by one MFC Partnership to another operate on the terms negotiated by the affected MFC Partnerships. The Holding Entity in relation to Sioux Falls compensates Sioux Falls on a cost-plus basis for the services, facilities, etc. of Sioux Falls made available to such Holding Entity to enable it to provide management services to the MFC Partnerships managed by such Holding Entity. The applicable Subco or Holding Entity reimburses the applicable MFC Partnership for all time spent by senior management of such MFC Partnership on activities related to the Subco or Holding Entity, at market rates (based on the executives' then current compensation).

***Amendment***

Each Partnership Agreement for each MFC Partnership provides that it can only be amended, modified or waived with the unanimous approval of the parties thereto.

## SUBCOS

Each Original Subco is a South Dakota limited liability company. OSH's related Subco is an Oklahoma limited liability company.

**Operating Agreement**

The following is a summary of certain provisions of the Subco operating agreement, entered into between the Issuer, Medical Facilities USA, each Subco and each Holding Entity with respect to certain matters relating to each Holding Entity, which summary is not intended to be complete. Reference is made to the Subcos' operating agreements for a complete description and the full text of their provisions.

***Ownership Restrictions***

The Subco is not permitted to sell, transfer or pledge its partnership interests in the applicable MFC Partnership to a third party without the prior approval of the board of managers of Medical Facilities USA. The Subco does not require the approval of Medical Facilities USA to exchange its Exchangeable Interest. Further, the Subco will not transfer its partnership interests in the applicable MFC Partnership or transfer IPSs it receives upon exchange of the Exchangeable Interests, and no membership interests in the Subco may be transferred, if such transfer might lead to a violation of the *Stark Act*.

***Amendment***

The Issuer and Medical Facilities USA have the right to approve any amendment to the operating agreement that would adversely affect their interests, including with respect to Subco's continued ownership of the Retained Interest.

**Retained Interests**

The Existing Partners in respect of each MFC Partnership indirectly hold 49% or less of the outstanding partnership interests in the respective MFC Partnership through their ownership interests in the related Holding Entity and the Holding Entity's ownership interest in the related Subco (please see "Ownership Structure").

Pursuant to the terms of the Exchange Agreement, each Subco is entitled to exchange 14% of the outstanding partnership interests in its related MFC Partnership (the "Exchangeable Interests") for IPSs (to the extent that such interest has not yet been exchanged). The balance of each Subco's partnership interests in its related MFC Partnership, representing a 35% partnership interest in such MFC Partnership, will not be exchangeable into IPSs or transferable by the respective Subco (the "Continuing Interests" and together with the Exchangeable Interests, the "Retained Interests").

***Distributions on Retained Interests***

The Retained Interest in each MFC Partnership entitles the related Subco to distributions on a pro rata basis equivalent to the distributions by such MFC Partnership to Medical Facilities USA. Consequently, prior to any exchange of Exchangeable Interests (whereupon the entitlements would be adjusted proportionately), each Subco will receive 49% of the distributions made by its related MFC Partnership, and Medical Facilities USA will receive 51% of such distributions. To date, only Black Hills has exercised its right to exchange a portion of its Exchangeable Interests and, as a result, its Subco is entitled to receive 47.05% of the distributions made by its related MFC Partnership.

**Exchange Agreements**

The following is a summary of certain provisions of the Exchange Agreements, which summary is not intended to be complete. Reference is made to each Exchange Agreement for a complete description and the full text of its provisions.

The Issuer, Medical Facilities USA and each Subco have entered into the Exchange Agreements. Subject to the limitations described below, the Exchange Agreements grant each Subco the right to periodically exchange all or any portion of its Exchangeable Interests in its related MFC Partnership for IPSs, based on the Exchange Ratio. The "Exchange Ratio" calculates the number of IPSs to be issued to a Subco in exchange for its Exchangeable Interests pursuant to a formula which considers factors such as the aggregate amount of cash distributed by the MFC Partnership to its related Subco in respect of the 12 month period (ending on the last day of the most recently completed fiscal quarter), the weighted average of the number of Retained Interests comprising partnership interests in the MFC Partnership owned by its related Subco during such period, as well as the aggregate amount of cash distributed to Medical Facilities USA by all MFC Partnerships, (and any other medical or surgical facilities in which Medical Facilities USA has an interest), in respect of the preceding 12 month (ending on the last day of the most recently completed fiscal quarter) and the weighted average number of IPSs outstanding during such period. For the purposes of exchange, the number of IPSs outstanding will be determined as if (i) no separations of IPSs into Common Shares and Subordinated Notes had occurred at any time, and (ii) no IPSs issued for cash were outstanding

until the cash proceeds of its issuance were expended by the Issuer or its subsidiaries, and where fewer than 12 months have elapsed since Closing such lesser number of months will be the calculation period.

Exchanges will occur quarterly (on the fifth business day after the public release of financial information for the immediately preceding quarter). The number of Exchangeable Interests exchanged for IPSs in any fiscal quarter will be subject to the following thresholds applicable to the MFC Partnerships, collectively, (i) a maximum exchange equal to 3% of the number of IPSs outstanding on the effective date of the exchange ("Maximum Exchange Amount"), and (ii) a minimum exchange equal to 1.5% of the number of IPSs outstanding on the effective date of the exchange ("Minimum Exchange Amount"). The Minimum Exchange Amount will not apply if the related Subco elects to bear the administrative and other costs associated with such an exchange. The Exchange Agreements require that IPSs acquired on exchange be immediately sold, unless their retention would not affect the regulatory status of the MFC Partnerships.

Subject to the right of the related Subco to exchange its Exchangeable Interest, a member of a Holding Entity has the right to redeem 28.57% of his, her or its membership interests in the Holding Entity. The Holding Entity has the option of paying for such redeemed membership interests in cash or IPSs. For purposes of any such redemption into IPSs, a member's membership interests in the Holding Entity will be redeemed based on an exchange ratio which calculates the number of IPSs to be issued to a Subco in exchange for its Exchangeable Interests pursuant to a formula which considers factors such as the aggregate amount of cash distributed by the MFC Partnership to its related Subco in respect of the 12 month period (ending on the last day of the most recently completed fiscal quarter), the weighted average of the number of Retained Interests comprising partnership interests in the MFC Partnership owned by its related Subco during such period, as well as the aggregate amount of cash distributed to Medical Facilities USA by all MFC Partnerships, (and any other medical or surgical facilities in which Medical Facilities USA has an interest), in respect of the preceding 12 month (ending on the last day of the most recently completed fiscal quarter) and the weighted average number of IPSs outstanding during such period.

The Exchange Agreements also provide that, in the event that a purchaser offers to purchase more than 20% of the membership interests in Medical Facilities USA held by the Issuer pursuant to an agreement with the Issuer, or 20% of the outstanding Common Shares (directly or through purchasing IPSs) pursuant to a non-exempt take-over bid in respect of which the Issuer proposes to enter into a support agreement with such purchaser, then it will be a condition of any such agreement or support agreement that the purchaser will offer to purchase a pro rata portion of the Exchangeable Interests of the MFC Partnerships held by each Subco, on the same terms and subject to the same conditions as are applicable to the purchase of the membership interests of Medical Facilities USA held by the Issuer or the Common Shares of the Issuer in accordance with the formula and restrictions set out in the Exchange Agreements. If an unsolicited non-exempt take-over bid from a person acting at arm's length to holders of the Exchangeable Interests is made for the IPSs (or the underlying Common Shares) and a contemporaneous offer on the same terms and conditions is not made for the Exchangeable Interests, then provided not less than 20% of the IPSs (or Common Shares), other than IPSs held at the date of the take-over bid by or on behalf of the offeror or associates or affiliates of the offeror, are taken-up and paid for pursuant to the bid, then from and after the date of first take-up under the bid the Exchangeable Interests will be exchangeable at an exchange ratio which results in the Exchangeable Interests being exchangeable for 110% of the number of IPSs into which they were exchangeable under the exchange ratio previously in effect. With respect to proposed sales by a Subco of its Retained Interests, each Subco will be prohibited from transferring its Retained Interest (other than exchanges of Exchangeable Interests) without the approval of the board of managers of Medical Facilities USA.

## HOLDING ENTITIES

Each Original Holding Entity is a South Dakota limited liability company. OSH's related Holding Entity is an Oklahoma limited liability company.

### Operating Agreement

The following is a summary of certain provisions of the Holding Entities' operating agreements, entered into between the Issuer, Medical Facilities USA, and each Holding Entity with respect to certain matters relating to each Holding Entity which summary is not intended to be complete. Reference is made to the Holding Entities' operating agreements for a complete description and the full text of their provisions.

***Ownership Restrictions***

The Holding Entity is not permitted to sell, transfer or pledge its membership interests in the respective Subco without the prior approval of the board of managers of Medical Facilities USA. Further, the Holding Entity will not transfer its membership interests in the applicable Subco if such transfer might lead to a violation of the *Stark Act*.

***Amendment***

The governing document provides that the Ownership Provisions listed below can only be amended, modified or waived with the approval of the board of managers of Medical Facilities USA. The other provisions of the Operating Agreement of the Holding Entity will not require the approval of the Issuer or Medical Facilities USA.

**Ownership Provisions**

The operating agreement governing the business and affairs of each Holding Entity provides as follows (note that Put Rights are only available to members of the Original Holding Entities):

***Mandatory Purchase and Sale***

In the event that a member of a Holding Entity retires, dies, or becomes permanently disabled (each a "Mandatory Repurchase Event"), the member will have the obligation to sell and, subject to the limitations described below, the Holding Entity will have the obligation to repurchase, the membership interests held by such member (each a "Mandatory Repurchase").

***Limited Put Rights of Members***

During the months of June and December of each year, a member may give the Original Holding Entity written notice (which must be received by the Holding Entity in such month) of the member's desire to compel the Original Holding Entity to repurchase a designated number of membership interests (a "Put") and, subject to the limitations described below, the Original Holding Entity will repurchase the designated number of membership interests (a "Put Repurchase").

***Closings***

Closings of Mandatory Repurchases which are the result of Mandatory Repurchase Events during the months of January through June, and Put Repurchases which are the result of Puts in the month of June, will occur as soon as reasonably practicable after June 30 ("First Semester Repurchases"). Closings of Mandatory Repurchases which are the result of Mandatory Repurchase Events during the months of June through December, and Put Repurchases which are the result of Puts in the Month of December, will occur as soon as reasonably practicable after December 31 ("Second Semester Repurchases").

***Limitations on Mandatory Repurchases and Put Purchases***

The maximum number of membership interests that the Holding Entity will be required to repurchase in any year pursuant to Mandatory Repurchases and Put Repurchases will be four percent (4%) of the difference between the number of membership interests outstanding as of the end of the prior calendar year less the number of membership interests repurchased during the current year by reason of Mandatory Repurchase Events and Puts which occurred during the prior year but for which the closing occurred during the current year (the "Maximum Repurchase Obligation"). First Semester Repurchases in any given year will correspondingly reduce the available Maximum Repurchase Obligation for Second Semester Repurchases in such year (possibly to zero). Membership interests which are to be redeemed pursuant to the right of a member to redeem 28.57% of his or her membership interests as described in the section entitled "Exchange Agreements" will not be subject to the limitations imposed by the Maximum Repurchase Obligation. In addition, the Holding Entity may, in its sole discretion, determine to repurchase membership interests in excess of the Maximum Repurchase Obligation provided that under no circumstances will the Holding Entity make repurchases which might adversely affect the MFC Partnership's exemption under the *Stark Act*.

If for any semester the sum of (i) the membership interests subject to Mandatory Repurchases; and (ii) membership interests that have been Put, or in the case of the Holding Entity related to OSH, the membership interest subject to Mandatory Repurchases alone, exceeds the Maximum Repurchase Obligation as of the end of that semester, then the membership interests to be repurchased by reason of the death of a member will have priority in the order of the deaths of the members over other repurchases, and all other membership interests to be repurchased will be repurchased on a pro rata basis rounded to the nearest whole number.

Any membership interests that are subject to a Mandatory Repurchase or which have been Put, but which are not repurchased at the end of a semester because of the limitations imposed by the Maximum Repurchase Obligation, will be carried forward to subsequent semesters without the requirement of further notice. In such cases, such deferred repurchases will have equal priority with other Mandatory Repurchases and Put Repurchases which are the result of Mandatory Repurchase Events and Puts during such semester; provided however, that membership interests to be repurchased by reason of the death of a member will have priority in the order of the deaths of the members over other repurchases. The purchase price to be paid for such deferred repurchases will be the purchase price in effect at the time of such deferred repurchase, not the purchase price in effect at the time of the initial Put or Mandatory Redemption Event.

***Option to Purchase — Physicians***

A Holding Entity has the right (but not the obligation) to purchase, without the approval of Medical Facilities USA, and a member has the obligation to sell, membership interests held by a physician member who no longer has privileges at the specialty hospital operated by the MFC Partnership, or relocates his or her primary residence outside of the "Service Area". The Service Area will be defined as that area within 50 miles of the site of the specialty hospital operated by the MFC Partnership.

***Option to Purchase — Non-Physicians***

A Holding Entity has the right (but not the obligation) to purchase without the approval of Medical Facilities USA, and the member has the obligation to sell, membership interests held by a member who is not a physician if they are no longer employees, members of the governing body, or entities providing comprehensive management services to the MFC Partnership.

***Sales to New Members***

Membership interests may be sold by a Holding Entity without the approval of Medical Facilities USA to (i) existing members of the Holding Entity; (ii) physicians on the medical staff of the specialty hospital operated by the applicable MFC Partnership; (iii) employees or members of the governing body of the MFC Partnership; and (iv) entities providing comprehensive management services to the MFC Partnership, provided in each case that the issuances will not lead to a violation of the *Stark Act*.

***Transfers of Membership Interests***

Membership interests may be transferred, sold or assigned by a member of a Holding Entity without the approval of Medical Facilities USA to (i) existing members of the Holding Entity; (ii) physicians on the medical staff of the MFC Hospital operated by the applicable MFC Partnership; (iii) employees or members of the governing body of the MFC Partnership; and (iv) entities providing comprehensive management services to the MFC Partnership, provided in each case that the issuances will not lead to a violation of the *Stark Act*. Any such transfer will be subject to the approval of the applicable Holding Entity.

***Offers to Sell***

Except as otherwise provided above, no membership interests may be sold or otherwise transferred without the prior approval of Medical Facilities USA and the Holding Entity. A member of a Holding Entity who desires to transfer his, her or its membership interests other than as provided above will offer them to the Holding Entity. In the event the Holding Entity elects to purchase less than all of such offered membership interests, the member may, in his, her or its discretion, elect to retain all of his, her or its offered membership interests.

***Purchase Price***

The purchase price for any issuance, transfer, sale, redemption, or offering of membership interests of an Original Holding Entity will be at fair market value as determined not less than annually by the board of managers of the Original Holding Entity. The purchase price for any issuance transfer, sale, redemption or offering of membership interests of OSH's related Holding Entity will be at the lesser of; (i) book value multiplied by the percentage interest of the departing members; and (ii) fair market value.

***Instalment Payments***

For any purchase or redemption of membership interests by the Holding Entity, the purchase price may, at the election of the governing board of managers, be paid over a period of five years in five annual instalments, with the first payment due at closing and the second, third, fourth and fifth instalments due on the first, second, third and fourth anniversaries of the closing (in exercising its discretion the governing board will consider the terms of the non-solicitation and non-competition agreements for the redeemed holder and the desirability of an instalment payment to ensure compliance with such agreements). Unless the Holding Entity otherwise determines, interest on the principal balance will be paid at the applicable federal interest rate in effect on the date of first payment.

**Non-Solicitation and Non-Competition Agreements**

Subject to the exceptions noted below, each Original Subco, each Original Holding Entity and each member of an Original Holding Entity (and the equity owners of any member that is not a natural person) has entered into a Non-Solicitation and Non-Competition Agreement pursuant to which such member is prohibited for so long as the executing party is a member of the Holding Entity and for a period of two years thereafter, without the consent of Medical Facilities USA, directly or indirectly, on his or her own behalf or in the service or on behalf of others, as a director, governor, trustee, owner (except as an owner of less than five percent of the outstanding stock of a publicly-owned corporation), employee, consultant, advisor, independent contractor or in any other capacity, engage in a business that is in competition with the MFC Original Partnerships and located within a 100 mile radius of the site of the related MFC Hospital. For purposes of the Non-Solicitation and Non-Competition Agreement, a business is deemed to be in competition with an MFC Hospital if it owns or operates a specialty hospital, general hospital or ambulatory surgery center, cardiac or catheterization services. The obligation to enter into a Non-Solicitation and Non-Competition Agreements does not apply to any member of the Holding Entity which is a non-profit organization and which owns and operates a general hospital, and certain existing arrangements and capacities will be grandfathered. The Non-Solicitation and Non-Competition Agreement do not affect a physician's right to refer patients to any other facility or in any way impede the exercise of the physicians medical judgement or preclude a physician member of an Original Holding Entity from performing procedures typically performed in the office setting if no additional license is required for the procedure and it does not typically involve the utilization of a professional anaesthesia provider. In addition, a physician's employment by a general hospital providing competing services shall not constitute a breach of the Non-Solicitation and Non-Competition Agreement.

Notwithstanding the foregoing, any person who is a member of the Original Holding Entity is exempted from the provisions of the Non-Solicitation and Non-Competition Agreement, but only (i) for those competing services provided in the office setting and billed by the member or by the professional practice which employs the member as of October 15, 2003 (including any employment in any hospital or clinic that provides competing services); (ii) to the extent the member had the capacity to provide such competing services as of October 15, 2003 with respect to equipment, space and staff (i.e. a member will be permitted to expand a competing service to the capacity of an underutilized piece of equipment); and (iii) at no more than the number of sites such services were offered by the member as of October 15, 2003.

The Spine Hospital's related Subco and Holding Entity and each member of the related Holding Entity (and the equity owners or representatives of any member that is not a natural person) entered into a Non-Solicitation and Non-Competition Agreement pursuant to which such member is prohibited for so long as the executing party is a member of the Spine Hospital's related Holding Entity and for a period of five years thereafter, without the consent of Medical Facilities USA, directly or indirectly, on his or her own behalf or in the service or on behalf of others, as a director, governor, manager, trustee, owner (except as an owner of less than five percent of the outstanding stock of a publicly-owned corporation), employee, consultant, advisor, independent contractor or in any other capacity to (i) engage in a business that is in competition with the Spine Hospital, (ii) maintain any financial relationship

(including any ownership or investment interest) with any business that is in competition with the Spine Hospital, (iii) develop, own, operate, lease, manage, invest in or finance any business that is in competition with the Spine Hospital, or (iv) provide financial, consulting or managerial assistance relating to the formation and/or operation of a business that is in competition with the Spine Hospital to any other person, company, business or enterprise that owns, operates or manages a business that is in competition with the Spine Hospital, each within Oklahoma County (or any counties contiguous to Oklahoma County). For purposes of the Non-Solicitation and Non-Competition Agreement, a business is deemed to be in competition with the Spine Hospital if it owns or operates a specialty hospital, general hospital, ambulatory surgery center, pain management facility, surgery center or other facility that provides surgical care or pain management services. The Non-Solicitation and Non-Competition Agreement do not affect a physician's right to refer patients to any other facility or in any way impede the exercise of the physicians medical judgement.

Each Non-Solicitation and Non-Competition Agreement includes provisions providing for the assignment (by power of attorney) of the holder's membership interest in such Holding Entity (and any entitlement to undistributed distributions) in the event of a breach of the agreement. The Non-Solicitation and Non-Competition Agreements in respect of an MFC Partnership will terminate on the successful enforcement of a remedy (including any petition into bankruptcy or appointment of a receiver) by a holder of Subordinated Notes under the Subordinated Note Guarantee or OSH Subordinated Note Guarantee against the MFC Partnership.

**Future Acquisitions**

In the event that a Holding Entity or Subco acquires an interest in an ambulatory surgical center, specialty hospital or traditional hospital which has been licensed as such for less than two years, it will (i) subject to transfer restrictions imposed by the agreement governing its interest, provide Medical Facilities USA with a right of first refusal on such interest (Medical Facilities USA will provide a reciprocal right in respect of any interest held by it), and (ii) use its commercially reasonable efforts to; (a) provide Medical Facilities USA with the option to acquire an equivalent interest in such facility on substantially similar terms and conditions; and (b) obtain for Medical Facilities USA a right of first offer on the remaining interest in the facility. Each MFC Partnership shall be compensated at market rates (based on the executives then current compensation and the time spent) for time devoted by management of such MFC Partnership to such development activities.

## DIRECTORS, OFFICERS AND MANAGEMENT

**The Issuer**

***Directors of the Issuer***

The Issuer's articles of continuance do not provide for a minimum or maximum of directors and there are no residency requirements. The directors of the Issuer are Alan J. Dilworth, Frank Cerrone, Dr. Gil Faclier, Seymour Temkin (Chair), Dr. Larry Teuber, Dr. Donald Schellpfeffer, Daniel Tasset and Irving Gerstein, a majority of whom are unrelated and independent (for regulatory purposes) to the Issuer and its subsidiaries. Each director of the Issuer has also been appointed to the board of managers of Medical Facilities USA. The term of office for each of the directors will expire at the time of the next annual meeting of shareholders of the Issuer. Directors will be elected at each annual meeting of shareholders of the Issuer. A director may be removed by a resolution passed by a majority of the shareholders or may resign on 30 days' notice. The vacancy created by the removal of a director must be filled at the shareholder meeting at which he or she was removed. A vacancy not so filled at a shareholder meeting, or created by the resignation of a director, may be filled by a quorum of the remaining directors. A quorum for meetings of directors is two directors. If there is no quorum of directors, a special shareholder meeting must be called to fill the vacancy.

The directors supervise the activities and manage the affairs of the Issuer, including acting for, voting on behalf of and representing the Issuer as a holder of membership interests in Medical Facilities USA.

***Committees of the Board of Directors***

*Audit Committee.* The Issuer has an audit committee that is comprised of Irving Gerstein, Frank Cerrone and Alan Dilworth (Chair), all of whom are unrelated and independent (for regulatory purposes) of the Issuer, Medical Facilities USA and the MFC Partnerships. A more detailed description of the audit committee is provided in the section entitled "Audit Committee and Auditors' Fees" below.

*Distributions Committee.* The members of the Issuer's distributions committee are Seymour Temkin (Chair), Alan Dilworth and Michael Salter, the Chief Financial Officer of the Issuer. The committee, the members of which are unrelated to and independent of the Issuer, approves and declares the monthly dividends on the Common Shares and the resultant distributions on the IPSs to be paid to IPS holders based on management's recommendations and monthly reports to the board of directors on distributions made to the IPS holders in the previous month.

*Compensation, Nominating and Corporate Governance Committee.* The members of the compensation, nominating and corporate governance committee are Frank Cerrone (Chair) and Dr. Gil Faclier. The committee reviews and makes recommendations to the directors concerning the appointment of officers of the Issuer and the hiring, compensation, benefits and termination of senior executive officers of the Issuer and the exercise of oversight rights over senior management of Medical Facilities USA and the MFC Partnerships The committee annually reviews the Chief Executive Officer's goals and objectives for the upcoming year and provides an appraisal of the Chief Executive Officer's performance. The committee also makes recommendations concerning the remuneration of the directors. The committee administers and makes recommendations regarding the operation of any employee bonus or incentive plans. The committee is also responsible for developing the Issuer's approach to corporate governance issues, advising the board on filling vacancies on the board and periodically reviewing the composition and effectiveness of the board, the contribution of individual managers, considering questions of management succession and considering and approving proposals by the directors to engage outside advisors on behalf of the directors of the Issuer. All of the members of the committee are independent of the Issuer, Medical Facilities USA and the MFC Partnerships.

***Remuneration of the Directors***

Compensation for directors of the Issuer is US$20,000 per year and US$1,500 per director for attending board or committee meetings in person. Directors receive US$500 for attending meetings by phone. The Chair of the board of directors receives an additional US$45,000 per year, the Chair of the Issuer's Audit Committee receives an additional US$15,000 per year, the Chair of the Issuer's Acquisition Committee receives an additional $3,000 per year and the Chair of the Compensation, Nominating and Corporate Governance Committee receives an additional US$3,000 per year for the performance of their respective duties. Directors are also reimbursed for out-of-pocket expenses for attending board meetings. Directors will participate in the insurance and indemnifications arrangements described below.

***Management***

The Issuer has three officers. Dr. Donald Schellpfeffer is the Chief Executive Officer, Dr. Larry Teuber is the President and Michael Salter is the Chief Financial Officer, and all hold similar positions in Medical Facilities USA. Primary responsibility for managerial and executive oversight of the business of the Issuer's subsidiaries is delegated to and discharged by Medical Facilities USA, including but not limited to oversight of: the business operations of the facilities, acquisition activities, budgeting processes and control procedures and policies.

***Policies***

The board of directors is also responsible for adopting and periodically reviewing and updating the policies of the Issuer. Such policies, among other things:

- articulate the legal obligations of the Issuer, its affiliates and their respective directors, managers, officers and employees with respect to confidential information;

- identify spokespersons of the Issuer who are the only persons authorized to communicate with third parties such as analysts, media and investors;
- provide guidelines on the disclosure of forward-looking information;
- require advance review by senior executives of any selective disclosure of financial information to ensure the information is not material, to prevent the selective disclosure of material information, and to ensure that if selective disclosure does occur, a news release is issued immediately; and
- establish "black-out" periods immediately prior to and following the disclosure of quarterly and annual financial results and immediately prior to the disclosure of certain material changes, during which periods the Issuer, its subsidiaries (including the MFC Partnerships), and (pursuant to undertakings in favour of the Issuer) the Subcos and Holding Entities and their respective managers, officers, employees and consultants may not purchase or sell IPSs, Common Shares or Subordinated Notes or securities exchangeable for or convertible into same.

**Medical Facilities USA**

***Board of Managers and Executive Officers of Medical Facilities USA***

Medical Facilities USA is governed in accordance with its constating documents and its Operating Agreement. Its board of managers is comprised of eleven individuals, a majority of whom are unrelated and independent (for regulatory purposes) to Medical Facilities USA and the MFC Partnerships and a majority of whom are U.S. residents. The board of managers of Medical Facilities USA is comprised as follows:

- six representatives of the Issuer (five directors of the Issuer and one independent US resident);
- two representatives of Black Hills;
- two representatives of Sioux Falls; and
- one representative of Dakota Plains;

The MFC Partnerships' representation on the Medical Facilities USA board of managers will be adjusted if the Retained Interests are reduced or diluted.

The board of managers of Medical Facilities USA, subject to the provisions of the Medical Facilities USA Operating Agreement, has full power to manage the business and affairs of Medical Facilities USA, to make all decisions regarding Medical Facilities USA and to bind Medical Facilities USA.

The following table sets out the name, municipality of residence, age, positions with the Issuer and Medical Facilities USA and principal occupation of the individuals who are managers and/or executive officers of Medical Facilities USA.

| Name and Municipality of Residence | Position(s) | Principal Occupation | Number of IPSs[12] |
|---|---|---|---|
| DR. PAUL CINK<br>Sioux Falls, South Dakota | Manager[1] | Ears Nose and Throat Surgeon | 87,863[6] |
| FRANK CERRONE<br>King City, Ontario | Director, Manager[4][13][14] | Senior Vice-President, General Counsel & Secretary, Retirement Residences Real Estate Investment Trust | 600 |

| Name and Municipality of Residence | Position(s) | Principal Occupation | Number of IPSs[12] |
|---|---|---|---|
| DR. R. BLAKE CURD<br>Sioux Falls, South Dakota | Manager[1] | Orthopaedic Surgeon | 87,863[7] |
| ALAN J. DILWORTH<br>Toronto, Ontario | Director, Manager[4][14][16] | Corporate Director | 2,350 |
| DR. GIL FACLIER<br>Willowdale, Ontario | Director, Manager[4][13] | Anaesthetist-in-Chief, Sunnybrook Health Sciences Center | 2,000 |
| DANIEL TASSET<br>Leawood, Kansas | Director, Manager[5] | Chairman and Chief Executive Officer, Nueterra Healthcare | Nil |
| DR. DONALD. G. FRISCO<br>Dakota Plains, South Dakota | Manager[3] | Physiatrist | 14,463[11] |
| IRVING GERSTEIN<br>Toronto, Ontario | Director, Manager[4][14][15] | Corporate Director | 2,000 |
| MICHAEL SALTER<br>Scottsdale, Arizona | Chief Financial Officer[15][16] | Financial Executive | 3,300 |
| DR. DONALD SCHELLPFEFFER<br>Sioux Falls, South Dakota | Chief Executive Officer, Director[4][15] | Anaesthesiologist | 263,415[8] |
| SEYMOUR TEMKIN<br>Toronto, Ontario | Director, Manager (Chair)[4][15][16] | Consultant | 14,900 |
| DR. LARRY L. TEUBER<br>Rapid City, South Dakota | Director, Manager, President[2][15] | Neurosurgeon | 764,520[9] |
| PATRICK A. TLUSTOS<br>Rapid City, South Dakota | Manager[2] | President, Hills Products Group, Rapid City | 151,444[10] |

(1) Representatives of Sioux Falls.

(2) Representatives of Black Hills.

(3) Representative of Dakota Plains.

(4) Representatives of the Issuer.

(5) U.S. resident unrelated to and independent from (for regulatory purposes) the Issuer, Medical Facilities USA and the MFC Partnerships.

(6) Dr. Paul Cink has an indirect 1.13% holding in Sioux Falls through his ownership in the related Holding Entity. 28.57% of this ownership interest is exchangeable into a maximum of 87,863 IPSs.

(7) Dr. Blake Curd has an indirect 1.13% holding in Sioux Falls through his ownership interest in the related Holding entity. 28.57% of this interest is exchangeable into a maximum of 87,863 IPSs.

(8) Dr. Donald Schellpfeffer has an indirect 4.07% holding in Sioux Falls through his ownership interest in the related Holding Entity. 28.57% of this ownership interest is exchangeable into a maximum of 263,415 IPSs.

(9) Dr. Larry Teuber has an indirect 14.60% holding in Black Hills through his ownership interest in the related Holding Entity. 25.61% of this ownership interest is exchangeable into a maximum of 764,520 IPSs.

(10) Patrick Tlustos has an indirect 1.94% holding in Black Hills through his ownership interest in the related Holding Entity. 25.61% of this ownership interest is exchangeable into a maximum of 101,444 IPSs. Mr. Tlustos directly owns an additional 50,000 IPSs.

(11) Dr. Donald G. Frisco has an indirect 2.33% holding in Dakota Plains through his ownership interest in the related Holding entity. 28.57% of this interest is exchangeable into a maximum of 14,463 IPSs.

(12) The managers and executive officers of Medical Facilities USA hold, either directly or indirectly through their ownership of Exchangeable Interests, approximately 1,394,718 IPSs in the aggregate (3.96% of all IPSs on a Fully-Diluted Basis).

(13) Indicates member of compensation, nominating and corporate governance committee.

(14) Indicates member of audit committee.

(15) Indicates member of acquisitions committee.

(16) Indicates member of distributions committee.

***Biographies***

**Dr. Paul Cink, M.D., FACS.** has been a manager of Medical Facilities USA since May 2006. Dr. Cink is a practising Ears, Nose and Throat surgeon at the MidWest Ear, Nose & Throat Hospital in Sioux Falls, South Dakota. Dr. Cink also practised for thirteen years at the North Central Head & Neck Hospital, also in Sioux Falls, South Dakota. Dr. Cink completed his post-graduate training in surgery and otolaryngology at the University of Texas Southwestern Medical School. Dr. Cink received a bachelor's degree from Baylor University College of Medicine and a Doctorate of Medicine from the University of Texas Southwestern Medical School.

**Frank Cerrone** has been a director of the Issuer since February, 2004 and a manager of Medical Facilities USA since March, 2004. Mr. Cerrone is a director of Keystone North America Inc. and Keystone Newport ULC and is also Senior Vice President, General Counsel and Secretary of Retirement Residences Real Estate Investment Trust and its subsidiaries. Mr. Cerrone joined Retirement REIT on April 30, 2002 on its combination with CPL Long Term Care Real Estate Investment Trust. Mr. Cerrone was Vice-President, Legal Services of CPL REIT from October 1998 to April 30, 2002. Prior to joining CPL REIT, Mr. Cerrone was Vice-President, Corporate Counsel of Investment Planning Counsel of Canada Ltd. (now IPC Financial Network Inc.). Mr. Cerrone was a partner with Gordon Traub and practiced corporate/commercial law specializing in mergers and acquisitions and corporate finance of health care facilities from 1989 to 1996.

**Dr. R. Blake Curd, M.D.** has been a manager of Medical Facilities USA since May, 2005. Dr. Curd is a practising orthopaedic surgeon specializing in hand, upper extremity and microvascular surgery. Dr. Curd serves on the Executive Committee of The Orthopedic Institute and is Chairman and Chief of Orthopedic Surgery for Avera-McKennan Hospital and University Health Center in Sioux Falls, South Dakota. He also sits on the Medical Executive Committee for Avera-McKennan Hospital. Dr. Curd is Clinical Assistant Professor for the University of South Dakota School of Medicine and is a frequent guest lecturer for graduate medical education, community education, and peer surgeon educational meetings. Dr. Curd spent ten years in the United States Air Force serving as a Flight Surgeon for a B-1 Bomber Squadron and as an Orthopedic Surgeon. Dr. Curd graduated from the University of Missouri at Kansas City School of Medicine with a Bachelor of Arts in both Biology and Chemistry and his Medical Doctorate. Dr. Curd completed his Orthopedic Surgery Residency Training in San Antonio, Texas and completed his fellowship in Hand, Upper Extremity, and Microvascular Surgery at the Indiana Hand Center/Indiana University.

**Alan J. Dilworth, FCA** has been a director of the Issuer since February, 2004 and a manager of Medical Facilities USA since March, 2004. He is a fellow of the Institute of Chartered Accountants and a corporate director. He was a partner of Deloitte & Touche LLP from 1963 until retiring from public accounting practice in 1995, having served as the firm's chairman and as a member of its board. Mr. Dilworth has previously served as a member of the board of directors of IGM Financial Inc., Mackenzie Financial Corporation and its US subsidiary, Mackenzie Investment Management Inc. He is chairman of St. Michael's Hospital (Toronto) Research Institute and previously served as a director and chairman of St. Michael's Hospital, a university teaching hospital in Toronto.

**Dr. Gil Faclier, M.D.** has been a director of the Issuer since February, 2004 and a manager of Medical Facilities USA since March, 2004. He is the current Anaesthetist-in-Chief of Sunnybrook and Women's College Health Sciences Center and has held this position since 2001. He also held the position of Director of Chronic Pain Management Program at Sunnybrook and Women's College Health Science Center since 2000. Dr. Faclier has over 35 years in general, intensive care, multidisciplinary pain management and anaesthesiology practices and has authored numerous medical publications. Dr Faclier is an assistant professor, Faculty of Medicine, University of Toronto, elected to the board of directors of Sunnybrook and Women's College Health Sciences Center and consultant for intensive care, pain management and currently, anaesthesiology. Dr. Faclier received his M.B., Ch.B from the University of Cape Town, South Africa and his FRCP(C) from the University of Toronto.

**Dr. Donald. G. Frisco, M.D.,** has been a manager of Medical Facilities USA since August 2005. Dr. Frisco is a practicing physiatrist (physical medicine and rehabilitation) and specializes in conservative management and rehabilitation of the spine and extremities at Orthopaedic Surgery Specialists in Aberdeen, South Dakota. Dr. Frisco graduated from the University of Wisconsin Medical School in 1994 and completed his medicine rehabilitation residency at the University of Wisconsin hospital and clinics in Madison, Wisconsin.

**Daniel R. Tasset,** has been a director of the Issuer since November 2006 and a manager of Medical Facilities USA since August 2006. Mr. Tasset is a trained CPA and provides professional and consulting services to physicians as Chairman and Chief Executive Officer of Nueterra Healthcare. Mr. Tasset has applied his experience to partner with physicians in developing ambulatory surgery centers and surgical hospitals. In 1997, Mr. Tasset co-founded the ASC Group. In 2002, the ASC Group became Nueterra Healthcare, to represent the new territory of outpatient healthcare. Under Mr. Tasset's leadership, Nueterra Healthcare has developed more than 70 ambulatory surgery centers, surgical hospitals and physical therapy centers in 24 states and employs more than 150 staff members at its corporate headquarters in Leawood, Kansas. Mr. Tasset is also CEO of Nueterra Real Estate Companies, a real estate development company focusing on medical and non-medical real estate.

**Irving Gerstein, C.M., O. Ont** has been a director of the Issuer and a manager of Medical Facilities USA since March, 2004. He is a retired executive. Mr. Gerstein is a director of Atlantic Power Corporation, Student Transportation of America Ltd., Student Transportation of America ULC and Economic Investment Trust Limited. He previously served as a director of other public issuers, including CTV Inc., Traders Group Limited, Guaranty Trust Company of Canada, Confederation Life Insurance Company and Scott's Hospitality Inc., and as an officer and director of Peoples Jewellers Limited. Mr. Gerstein is a Member of the Order of Canada and a Member of the Order of Ontario. He is an honorary director of Mount Sinai Hospital (Toronto), having previously served as Chairman of the Board, Chairman Emeritus and a director over a period of twenty-five years, and is currently a member of its Research Committee. Mr. Gerstein received his BSc. in Economics from the University of Pennsylvania (Wharton School of Finance and Commerce). During Mr. Gerstein's service as a director of each of Peoples Jewellers Limited and Confederation Life Insurance Company bankruptcy proceedings were initiated (and, in the case of Peoples Jewellers Limited, claims were made against senior executives of the company, including Mr. Gerstein); all of the creditor and other claims were settled. Mr. Gerstein also entered into a settlement of personal claims arising primarily from participation in a Peoples Jewellers Limited share incentive plan.

**Michael Salter, CA, CPA** has been the Chief Financial Officer of the Issuer and Medical Facilities USA since February, 2004. He has acted as an accounting and financial consultant for various clients since 2001, including the U.S. subsidiaries of a Canadian based, publicly traded, merchant banking conglomerate, and more recently for Advisory Services, Inc., Scottsdale, Arizona. Prior to his current position, Mr. Salter was Corporate Controller from 1998 to 2001 for Olympus Hospitality Group, LLC, a hotel management company that had a portfolio of six destination resorts and a franchised hotel chain. Mr. Salter has held numerous financial management positions, including Risk Manager, Controller, and Chief Financial Officer. Mr. Salter is a Chartered Accountant and received his CPA certification in 1995.

**Dr. Donald Schellpfeffer, M.D.** has been a director of the Issuer since May, 2005. He is the current Medical Director of Sioux Falls Surgical Center and is President of Anesthesiology Associates. As an original founder of the Sioux Falls Surgical Center, Dr. Schellpfeffer has been the Medical Director and a member of the Management Committee since the facility's inception in 1985. He has over 19 years of experience in ambulatory surgical environments, and 22 years in general, cardiovascular, and trauma practices and has also authored numerous medical publications. Dr. Schellpfeffer received a Bachelor of Science from the University of Wisconsin; a Masters of Science, a Bachelor of Science from the College of Veterinary and Medicine and PHD in animal physiology each from the University of Minnesota and M.D. from University of South Dakota School of Medicine and completed his residency in Anesthesiology in Wisconsin.

**Seymour Temkin, C.A., FMCA** has been a director of the Issuer since January, 2004 and a manager of Medical Facilities USA since March, 2004. He is a member of Goodmans LLP's REITs and Income Funds Group where he provides strategic and business advisory services to public and private companies. Prior to joining Goodmans LLP in 2002, Mr. Temkin headed the Canadian real estate practice of Deloitte & Touche LLP for 15 years and has over 30 years of public accounting experience. Mr. Temkin was also a director of First Capital Realty Inc., a TSX listed company. Mr. Temkin is a Chartered Accountant with an FCMA designation and Bachelor of Commerce degree from the University of Witzwaterand, South Africa.

**Dr. Larry L. Teuber, M.D.** has been a director of the Issuer since December, 2004 and a manager of Medical Facilities USA since March, 2004. He is a founder and Physician Executive of Black Hills Surgery Center and President of the Issuer. Dr. Teuber is a Board Certified Neurosurgical Surgeon and is also managing partner and founder of The Spine Center in Rapid City, South Dakota. He provides consultative services and frequently speaks

to physician organizations concerning the development of surgical facilities and Centers of Excellence for neurosurgical and spinal care.

**Patrick A. Tlustos** has been a manager of Medical Facilities USA since March, 2004. He has been on the management committee of Black Hills Surgery Center for the past six years and is also currently President of Hills Products Group, a regional company involved in both owned and managed residential and commercial real estate, lumber production and sales, hotel and motels, apartments and site development. Prior to that time, from 1986 to 2000 Mr. Tlustos was President of Hills Materials Company Inc., a 500 person firm specializing in construction materials and highway paving. Mr. Tlustos has a degree in Civil Engineering.

***Committees and Remuneration of the Board***

The audit committee of the Issuer assists the managers in fulfilling their responsibilities of oversight of the accounting and financial reporting practices and procedures of Medical Facilities USA and its subsidiaries, monitoring the adequacy of internal accounting controls and procedures and reviewing the quality and integrity of financial statements. Each member of the audit committee is unrelated and independent (for regulatory purposes) of the Issuer, Medical Facilities USA and the MFC Partnerships. In addition, the board of managers has an acquisitions committee that assists the board in identifying and pursuing strategic acquisitions.

*Remuneration of Managers of Medical Facilities USA.* Compensation for Non-Management managers of Medical Facilities USA (other than managers who are also directors of the Issuer) is US$20,000 per year for independent managers, US$10,000 for managers appointed by Subcos and US$1,500 per meeting for attending board or committee meetings in person. Managers receive US$500 for attending meetings by phone. Managers are reimbursed for out-of-pocket expenses for attending board and committee meetings. Managers participate in the insurance and indemnification arrangements described below.

***Long Term Incentive Plan***

Medical Facilities USA has adopted a Long-Term Incentive Plan ("**LTIP**") for its managers, officers and employees as well as those of certain of its affiliates ("**Eligible Participants**"). The purpose of the LTIP is to promote a greater alignment of interests between Eligible Participants who participate in the Plan and the securityholders of the Issuer by providing incentives for improved performance and accretive acquisitions. Incentive awards will generally be made on an annual basis based on increases in the distributable cash for that year over the base distribution set by the Board for such year. Adjustments will be made to LTIP awards to exclude the performance of a physician's own center where his/her awards are concerned (as a result of U.S. regulatory considerations). Awards are payable annually in cash.

For each financial year, the maximum value of the awards payable under the LTIP shall be a portion (the "**Prescribed Portion**") of the amount by which the distributable cash for that year exceeds the base distribution fixed by the board for such year, adjusted for each Eligible Participant who performs medical services at an MFC Partnership to exclude distributable cash earned by such MFC Partnership (the "**Excess**"). The maximum amount of such awards shall be calculated as follows:

| **Percentage by which Excess exceeds Base Distribution or Adjusted Base Distribution** | **Prescribed Portion of Excess** |
|---|---|
| 5% or less | 10% |
| more than 5%, less than 10% | 15% |
| 10% or more, less than 20% | 20% |
| 20% or more | 30% |

The board of directors of Medical Facilities USA administers the LTIP and has the sole and entire authority to determine the Eligible Participants who will participate in the LTIP as well as their level of participation in the plan.

**Management of the MFC Partnerships**

Each MFC Partnership is governed by its Partnership Agreement. The management committee for each MFC Partnership is comprised of individuals appointed by the management committee of the applicable Subco and one representative of Medical Facilities USA. Each MFC Partnership's business and affairs is managed by its management committee, subject to the terms of its governing partnership agreement. The terms of the partnership agreements provide that certain matters will be subject to the approval of Medical Facilities USA's board of managers, including any reduction in distributions, certain budgeting matters, material deviations from budget and specified fundamental transactions.

***Long-Term Compensation Plan***

Each MFC Partnership may adopt a Long-Term Compensation Plan ("LTCP") for key members of its management, who are not licensed physicians. The purpose of the LTCP is to provide eligible participants with compensation opportunities that will enhance each MFC Partnership's ability to attract, retain and motivate key personnel, and reward key members for significant performance of non-medical services. Pursuant to the LTCP, each MFC Partnership may set aside a pool of funds based upon the amount (the "Surplus") by which each MFC Partnership's distributions to Medical Facilities USA and its related Subco exceed a specified threshold amount (such threshold effectively representing a cumulative 5% growth rate).

The management committee of each MFC Partnership would have the power to determine, from time to time, who is eligible to participate in, and the allocation of the awards under, any such LTCP.

**Insurance Coverage for the Issuer and Related Entities and Indemnification**

The Issuer has obtained policies of insurance for the directors and officers of the Issuer and for the managers and officers of Medical Facilities USA, the Issuer's subsidiary. The aggregate limit of liability applicable to the insured directors, managers and officers under the policy is Cdn$20 million including defence costs. Under the policies, each entity has reimbursement coverage to the extent that it has indemnified its directors, managers and officers. The policies include securities claims coverage, insuring against any legal obligation to pay on account of any securities claims brought against the Issuer or Medical Facilities USA. The aggregate limit of liability is shared among the Issuer and Medical Facilities USA and any of their respective directors, managers and officers so that the limit of liability is not exclusive to either of the entities or their respective directors, managers and officers. Each of Black Hills and Sioux Falls have also independently obtained policies of insurance for their directors and officers.

The by-laws of the Issuer, the Operating Agreement of Medical Facilities USA and the Partnership Agreements for each MFC Partnership provide for the indemnification of their respective directors, managers and officers from and against liability and costs in respect of any action or suit brought against them in connection with the execution of their duties or office, subject to certain limitations.

## AUDIT COMMITTEE AND AUDITOR'S FEES

The Issuer established an audit committee comprised of three directors: Alan Dilworth (Chair), Irving Gerstein and Frank Cerrone, each of whom is "independent" of the Issuer, Medical Facilities USA and the MFC Partnerships and "financially literate" within the meaning of Multilateral Instrument 52-110 – Audit Committees. The audit committee is responsible for oversight of the accounting and financial reporting practices and procedures of the Issuer, monitoring the adequacy of internal accounting controls and procedures and reviewing the quality and integrity of financial statements of the Issuer. The independent auditors of the Issuer report directly to the audit committee. In addition, the audit committee is responsible for reviewing and approving the auditors' examination and for recommending to the board of directors the selection of independent auditors of the Issuer. The charter of the audit committee is attached hereto as Appendix "A".

**Relevant Education and Experience of Audit Committee Members**

The following is a brief summary of the education or experience of each member of the audit committee that is relevant to the performance of his responsibilities as a member of the audit committee, including any

education or experience that has provided the member with an understanding of the accounting principles used by the Issuer to prepare its annual and interim financial statements:

| Name of Audit Committee Member | Relevant Education and Experience |
|---|---|
| Alan Dilworth (Chair) | Mr. Dilworth, a fellow of the Institute of Chartered Accountants, has over thirty years of public accounting experience. He was a partner of Deloitte & Touche LLP from 1963 until his retirement from public practice in 1995, having served as the firm's chairman and as a member of its board. Since retiring from public practice, he has served as a member or chair of audit committees of several public companies more fully described in the section entitled "Medical Facilities USA – Biographies" above and was awarded the Audit Committee Certified designation by the Directors College of McMaster University. |
| Irving Gerstein | Mr. Gerstein is a member of the audit committees of Atlantic Power Corporation, Student Transportation of America Ltd., Student Transportation of America ULC and Economic Investment Trust Ltd. These positions, in conjunction with his economics background and his previous experience as a director of several public issuers (as more fully described in the section entitled "Medical Facilities USA– Biographies" above) have enabled him to develop a strong understanding of accounting principles sufficient to ensure his financial literacy. |
| Frank Cerrone | Mr. Cerrone is a director and member of the audit committee of Keystone North America Inc. As part of the senior management team of Retirement Residences Real Estate Investment Trust, Mr. Cerrone is involved in the ongoing review of the financial statements and financial reporting of a large public issuer. In October 2005, Mr. Cerrone attended the financial literacy course for senior officers and directors held at the Joseph L. Rotman School of Business at the University of Toronto. Through this course and in this position, he has developed an understanding of accounting principles and internal controls and procedures for financial reporting sufficient to ensure his literacy in financial matters. |

**Non-Audit Services**

The Issuer's audit committee has adopted specific policies and procedures for the engagement of external auditors for all services, including non-audit services. The policies generally require audit committee approval for all such engagements.

**External Auditor Service Fees**

The table below provides greater disclosure of the services provided and fees earned by the Issuer's external auditor over the two most recently completed fiscal years, dividing the services into the four categories of work performed.

| Type of Work | Fees - Fiscal 2006 | Fees - Fiscal 2005 |
|---|---|---|
| Audit fees [1] | Cdn$95,000 (i)<br>US$164,000 (ii)<br>Cdn$111,000 (iii)<br>Cdn$40,000 (iv) | Cdn $80,000<br>Cdn $151,600<br>US $162,000 |
| Audit related fees [2] | Cdn$71,000 | Cdn $ 60,500 |

| Type of Work | Fees - Fiscal 2006 | Fees - Fiscal 2005 |
|---|---|---|
| | | US $25,500<br>Cdn $45,000 |
| Tax fees [3] | Cdn$20,100 | Cdn $ 9,000 |
| | | US $18,500 |
| All other fees [4] | None | None |

(1) For the year ended December 31, 2006, audit fees were billed for professional services rendered by the auditors: (i) for the audit of the Issuer's consolidated financial statements for the year ended December 31, 2006; (ii) for the audit of the Centers for the year ended December 31, 2006; (iii) for a review of the interim consolidated financial statements of the Issuer for Q1, Q2 and Q3 2006; and (iv) for a review related to the restatement of the consolidated financial statements of the Issuer for the year ended December 31, 2005 and the interim consolidated financial statements for Q1 and Q2 2006.

(2) Audit-related fees were billed for assistance with the planning and documentation of the Issuer's internal controls over financial reporting.

(3) Tax fees were billed in 2006 for professional services rendered by the auditors for tax compliance.

(4) No fees were billed for products and services other than the audit services, audit-related services and tax services described above.

**Audit Committee Oversight**

At no time since the commencement of the Issuer's most recently completed financial year has a recommendation of the audit committee to nominate or compensate an external auditor not been adopted by the board of directors.

## RISK FACTORS

**Risks Related to the Business and the Industry of the MFC Partnerships**

***Reliance on Third Party Payors for Revenue and Profitability***

The revenue and profitability of the MFC Partnerships depend heavily on payments from third-party payors, including government health care programs and managed care organizations. Payments from government and private insurance payors represent a significant portion of the revenues of the MFC Partnerships. If payments from these third-party payors were reduced or eliminated, the revenue and profitability of the MFC Partnerships may be adversely affected.

Details regarding some of the key third-party payors are described below.

***Medicare and Medicaid Programs***

Medicare and Medicaid are the commonly used names for reimbursement or payment programs governed by certain provisions of the United States federal Social Security Act. Medicare is an exclusively federal program, while Medicaid is a combined federal and state program. Medicare provides certain healthcare benefits primarily to beneficiaries who are 65 years of age or older. Medicaid is designed to provide certain healthcare benefits to low-income individuals.

Healthcare providers have been affected significantly by recent changes in healthcare laws and regulations, particularly those pertaining to Medicare and Medicaid. The purpose of much of the recent statutory and regulatory activity has been to limit or reduce healthcare costs, particularly costs paid under the Medicare and Medicaid programs. Diverse and complex mechanisms to limit the amount of money paid to healthcare providers under both the Medicare and Medicaid programs have been enacted and have caused significant reductions in payments to health care providers from these programs including the MFC Partnerships. In addition, Congress has reduced the level of reimbursement by Medicare to ambulatory surgical centers. In the future, Congress may consider a reduction in payment to specialty hospitals for Medicare services. The efforts to reduce the costs of the Medicare and Medicaid programs are likely to continue, and there can be no assurance that such efforts will not adversely affect the financial condition of the MFC Partnerships.

***Managed Care Plans/Third Party Payors***

Providers of managed care plans and third party commercial health insurance plans generally seek to enter into agreements with healthcare providers which provide for discounts and other economic incentives to reduce or limit the cost and utilization of the healthcare services which are paid for under those plans. As a result, payments to healthcare providers from managed care plans and third party commercial health insurance plans typically are lower than billed charges from the provider.

The MFC Partnerships have entered into a number of contracts with managed care providers and third party commercial health insurance plans. There can be no assurance that the MFC Partnerships will maintain their current contracts or obtain other similar contracts in the future. In addition, management expects that managed care providers and third party commercial health insurance plans will continue to focus on cost containment measures and this could have a negative impact on the revenues and profitability of the MFC Partnerships in the future.

***Licensing, Certification and Accreditation Requirements***

Healthcare facilities, such as the MFC Hospitals, are subject to numerous legal, regulatory, professional and private licensing, certification and accreditation requirements. These include, but are not limited to, requirements imposed by Medicare, Medicaid, State licensing authorities and private payors. Receipt and renewal of such licenses, certifications and accreditations are often based on inspections, surveys, audits, investigations or other reviews, some of which may require affirmative compliance actions by the MFC Partnerships that could be burdensome and expensive.

Management believes that the MFC Partnerships are currently in material compliance with all applicable licensing, certification and accreditation requirements. The applicable standards may change in the future, however, and there can be no assurance that the MFC Partnerships will be able to maintain all necessary licenses or certifications or that they will not be required to incur substantial costs in doing so. The failure to maintain all necessary licenses, certifications and accreditations, or the requirement to incur substantial costs to maintain them, could have a material adverse effect on the business of the MFC Partnerships.

In addition, in order to perform medical procedures in South Dakota and Oklahoma, physicians must be licenced by the applicable state board of medical and osteopathic examiners. There can be no assurance that any particular physician that has medical staff privileges at the MFC Hospitals will not have their licence suspended or revoked by the applicable state board of medical and osteopathic examiners. If such a licence is suspended or revoked, the physician will not be able to perform surgical procedures at the MFC Hospitals which may have a material adverse affect on the operations and business of that MFC Partnerships.

***Regulatory Requirements***

The regulatory requirements of the MFC Hospitals are fundamental to the operation of the hospitals and financial performance of the MFC Partnerships.

There are a number of United States federal and state regulatory initiatives which specifically apply to healthcare providers, including the MFC Partnerships. Among the most significant are:

- the federal Anti-Kickback Statute;
- the federal *Stark Act*; and
- the federal rules relating to management and protection of patient records and patient confidentiality.

Investors are encouraged to read this Annual Information Form's detailed description of the requirements of the Anti-Kickback Statute, the *Stark Act* and the rules relating to patient records and confidentiality as well as the detailed discussion under the heading "Regulation" beginning on page 17.

While management believes the MFC Partnerships are currently in compliance with the requirements of these regulatory initiatives and expects such compliance will continue in the future, there can be no assurance that

the MFC Partnerships will not violate the requirements of one or more of these laws or that it will not have to expend significant amounts to ensure compliance. A violation of these requirements could subject the MFC Partnerships to criminal or civil penalties and/or exclusion from future participation in programs such as Medicare or Medicaid. Any of these outcomes could have a material adverse affect on the business of the MFC Partnerships.

In addition to the regulatory initiatives described above, healthcare facilities, including the MFC Hospitals, are subject to a wide variety of federal, state, and local environmental and occupational health and safety laws and regulations that affect their operations, facilities, and properties. Violations of these laws could subject the MFC Partnerships to liability for investigating and remedying any contamination by hazardous substances, as well as civil or other damages and penalties.

Typical hospital operations include the handling, use, storage, transportation, disposal and discharge of hazardous, infectious, toxic, radioactive, flammable, and other hazardous materials, wastes, pollutants, or contaminants. Although management believes the MFC Partnerships are currently in material compliance with all applicable environmental laws and regulations, and expects such compliance will continue in the future, there can no assurance that the MFC Partnerships will not violate the requirements of one or more of these laws or that it will not have to expend significant amounts to ensure compliance. A violation of these requirements could have a material adverse affect on the business of the MFC Partnerships.

***Dependence on Physician Relationships***

The success of each MFC Partnership depends, in part, on the ability of that MFC Partnership to attract surgeons and other physicians in the MFC Partnership's service area to perform surgical procedures at the MFC Hospital. Although the MFC Partnerships have had success in attracting surgeons and other physicians in the past, there can be no assurance that such success will continue in the future. In addition, there can be no assurance that physician groups performing procedures at the MFC Hospitals will maintain successful medical practices or that one or more key members of a particular physician group will continue practicing with that group or that the members of that group will continue to perform procedures at the MFC Hospitals at current levels, or at all.

***Lack of Diversification in the Business of the Issuer and the MFC Partnerships***

The only business of the MFC Partnerships is the operation of the three MFC Hospitals. The MFC Partnerships and the Issuer are, therefore, entirely dependent upon the success of these three hospitals. Investors will not have the benefit of any further diversification of operations or risk.

***Litigation, Professional Liability Claims and Availability of Insurance***

The MFC Partnerships are, from time to time, subject to litigation claims in the ordinary course of their business. In particular, the MFC Partnerships can be subject to claims relating to actions of medical personnel performing services at the MFC Partnership. Historically, the MFC Partnerships have been able to obtain what management believes is adequate insurance to cover these risks. However, the cost of this insurance is increasing and there can be no assurance that the MFC Partnerships will be able to obtain adequate insurance in the future on economically reasonable terms, or at all. If the insurance which the MFC Partnerships have in place from time to time is not sufficient to cover claims which are made, the resulting shortfall could have a material adverse affect on the business and operations of the MFC Partnerships.

***Access to Capital Resources for Expansion of Facilities***

The growth strategy of the MFC Partnerships includes expanding the procedures offered by each MFC Hospital and the facilities available for use at the MFC Hospitals. Any such expansions will require additional capital which may be funded through additional debt or equity financings. To the extent that financing is raised through the issuance of IPSs or other securities of the Issuer, current holders of IPSs may experience ownership dilution. To the extent debt is incurred, either the Issuer or the MFC Partnerships may incur significant interest expense and may be subject to covenants in the related debt agreements that affect the conduct of business. Without sufficient capital resources to implement this strategy, the MFC Partnerships' future growth could be limited and operations impaired. There can be no assurance that additional financing will be available to fund this growth

strategy or that, if available, the financing will be on terms that are acceptable to the MFC Partnerships and the Issuer.

***Regulations Affecting Expansion of Facilities***

Efforts to regulate the expansion of healthcare facilities could prevent the MFC Partnerships from renovating their existing facilities or expanding the breadth of services they offer. In some cases, prior regulatory approval is required for the expansion of healthcare facilities or the services those facilities offer. In granting such approvals, regulators may consider, among other things, the need for additional or expanded healthcare facilities or services in the local area.

If the MFC Partnerships are unable to obtain required approvals, they may not be able to expand current facilities or expand the breadth of services offered. This could have a material adverse affect on the growth strategy and the business of the MFC Partnerships.

***Competition from Other Healthcare Providers***

The healthcare business is highly competitive. The MFC Partnerships compete with other healthcare providers (primarily hospitals and other surgery centers) in recruiting physicians to utilize their facilities and in contracting with managed care payors in each of their markets. Some of the competing facilities have long-standing and well established relationships with physicians and third-party payors. Some are also significantly larger than the MFC Hospitals and have access to more marketing and other resources than are available to the MFC Partnerships. In addition, other health care facilities may not allow physicians who are on the medical staffs of the MFC Hospitals to have medical privileges at their facilities. The traditional hospital located in Aberdeen currently prohibits new physicians who are added to the medical staff at the Dakota Plains Surgical Center from practicing at this facility. This restriction on a physician's practice may cause physicians to not seek medical staff privileges at the MFC Hospitals and may restrict the MFC Hospitals' ability to attract new or additional doctors to practice at their facilities.

If the MFC Partnerships are unable to compete effectively with these entities to recruit new physicians or enter into arrangements with managed care payors, the ability of the MFC Partnerships to implement their growth strategies successfully could be adversely affected.

***Other Risk Factors***

In addition to the foregoing risk factors, the following additional risk factors may affect the operations of the MFC Partnerships:

- the MFC Partnerships are employers, combining a complex mix of professional, quasi-professional, technical, clerical, housekeeping, maintenance, dietary and other types of workers in a single operation. As with other employers, the MFC Partnerships bear a wide variety of risks in connection with their employees. These risks include work actions, contract disputes, discrimination claims, personal tort actions, work-related injuries, exposure to hazardous materials, interpersonal torts (such as between employees, between physicians or Management and employees, or between employees and patients), and other risks that may flow from the relationships between employer and employee or between physicians, patients and employees. Many of these risks are not covered by insurance, and certain of them cannot be anticipated or prevented in advance, and such risks, alone or in combination, could have material adverse consequences to the financial condition or operations of the MFC Partnerships.

- certain key physicians at the MFC Hospitals are not investors and, as a result, will not be subject to the non-competition and non-solicitation agreements described above.

- the occurrences of natural disasters may damage some or all of the MFC Hospitals, interrupt utility service to some or all of the MFC Hospitals or otherwise impair the operation of some or all of the MFC Hospitals operated by the MFC Partnerships or the generation of revenues from the MFC Hospitals.

- scientific and technological advances, new procedures, drugs and appliances, preventive medicine, occupational health and safety and outpatient healthcare delivery may reduce utilization and revenues of the MFC Partnerships. Technological advances in recent years have accelerated the trend toward the use by hospitals of sophisticated and costly equipment and services for diagnosis and treatment. The acquisition and operation of certain equipment or services may continue to be a significant factor in utilization, but the ability of the MFC Hospitals to offer the equipment or services may be subject to the availability of equipment or specialists, governmental approval or the ability to finance these acquisitions or operations.

- reduced demand for the MFC Hospitals' services that might result from decreases in population in the service areas of the MFC Hospitals.

- the United States is currently experiencing a severe shortage of nursing staff. The failure of the MFC Hospitals to hire and retain qualified personnel could have a material adverse affect on the operations and business of the MFC Hospitals.

- increased unemployment or other adverse economic conditions in the MFC Hospitals' service areas, which would increase the proportion of patients who are unable to pay fully for the cost of their care, could also adversely affect the business of the MFC Partnerships.

**Risks Related to the Structure of the Issuer**

***The Issuer is Dependent on the MFC Partnerships for all Cash Available for Distributions***

The Issuer is dependent on the operations and assets of the MFC Partnerships through the indirect ownership of 51% of those partnerships. Cash distributions to holders of IPSs, Common Shares or Subordinated Notes are dependent on the ability of Medical Facilities USA to make distributions to the Issuer, which in turn is dependent on the ability of the MFC Partnerships to make distributions to Medical Facilities USA. The actual amount of cash available for distribution to holders of the IPSs, Common Shares or Subordinated Notes will depend upon numerous factors relating to the each of the MFC Partnerships, including profitability, changes in revenues, fluctuations in working capital, the sustainability of EBITDA margins, capital expenditure levels, applicable laws and contractual restrictions contained in the instruments governing any indebtedness. Any reduction in the amount of cash available for distribution, or actually distributed, by the MFC Partnerships or Medical Facilities USA will reduce the amount of cash available for the Issuer to make distributions to holders of IPSs, Common Shares or Subordinated Notes. As a result, cash distributions by the Issuer are not guaranteed and will fluctuate with the performance of the MFC Partnerships.

***Limited Controls***

The Issuer has (subject to increase on the exchange of Exchangeable Interests) an indirect 51% interest in each MFC Partnership, through its wholly-owned subsidiary Medical Facilities USA. Medical Facilities USA exercises its control of each MFC Partnership through its contractual rights. However, Medical Facilities USA has the right to appoint only one member of each MFC Partnership's management committee and as such, except in the circumstances of a default and through the exercise of its contractual rights, it does not have the ability to direct day-to-day management of the MFC Partnerships.

***Distribution of all Available Cash May Restrict Potential Growth of the MFC Partnerships and the Issuer***

The payout by the MFC Partnerships of substantially all of their operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of these funds could limit the future growth of each MFC Partnership and its cash flow. In addition, the Issuer may be precluded from pursuing otherwise attractive acquisitions because they may not be accretive to the Issuer on a short-term basis.

***Future Distributions are not Guaranteed***

The Issuer's, Medical Facilities USA's and the MFC Partnerships' boards of directors or managers may, in their respective discretion, amend or repeal the existing distribution policy. Future distributions from these companies, if any, will depend on, among other things, the results of operations, cash requirements, financial condition, contractual restrictions, business opportunities, provisions of applicable law and other factors that the board of directors or managers may deem relevant. Any of these boards of directors or managers may decrease the level of distributions provided for in their existing distribution policies or entirely discontinue distributions.

***Exchange Rate Fluctuations May Impact the Amount of Cash Available for Distribution by the Issuer***

The Issuer's distributions to holders of IPSs, Common Shares or Subordinated Notes are denominated in Canadian dollars. Conversely, all of the MFC Partnerships' revenues and expenses, together with distributions received by the Issuer from Medical Facilities USA and by Medical Facilities USA from the MFC Partnerships are denominated in U.S. dollars. As a result, the Issuer is exposed to currency exchange rate risks.

Although the Issuer has entered into hedging arrangements to mitigate this exchange rate risk, there can be no assurance that these arrangements are sufficient to fully protect against this risk. If the hedging transactions do not fully protect against this risk, a change in the currency exchange rate between U.S. and Canadian dollars could have a material adverse effect on the Issuer's ability to maintain a consistent level of distributions in Canadian dollars.

***Substantial Indebtedness Could Negatively Impact the Business of the Issuer and the MFC Partnerships***

The degree to which the Issuer is leveraged on a consolidated basis could have important consequences to the holders of the IPSs, including:

- the Issuer's, Medical Facilities USA's and the MFC Partnerships' ability in the future to obtain additional financing for working capital, capital expenditures or other purposes may be limited;
- the Issuer or MFC Partnerships being unable to refinance indebtedness on terms acceptable to the Issuer or at all;
- a significant portion of the Issuer's cash flow (on a consolidated basis) from operations is likely to be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future operations, capital expenditures and/or dividends on its Common Shares; and
- the MFC Partnerships may be vulnerable to economic downturns and be limited in their ability to withstand competitive pressures.

The indenture governing the Subordinated Notes represented by the IPSs will not limit the Issuer's ability to issue additional notes to be represented by additional IPSs in connection with the exchange of the Exchangeable Interests pursuant to the Exchange Agreement.

***Restrictive Covenants in Credit Facilities Could Impact the Business of the Issuer and the MFC Partnerships***

The Credit Facilities contain restrictive covenants that limit the discretion of the MFC Management with respect to certain matters. The ability of the MFC Partnerships to make distributions will be subject to the restrictive covenants contained in each Credit Facility.

***Future Issuances of IPSs or Common Shares Could Result in Dilution***

The Issuer's articles of incorporation authorize the issuance of an unlimited number of Common Shares for that consideration and on those terms and conditions as are established by the board of directors without the approval of any shareholders. Additional IPSs or Common Shares may be issued by the Issuer pursuant to the Exchange Agreement or in connection with a future financing or acquisition by the Issuer. The issuance of

additional IPSs or Common Shares may dilute an investor's investment in the Issuer and reduce distributable cash per Common Share or per IPS.

***Limitations on Enforcement of Certain Civil Judgments by Canadian Investors***

Medical Facilities USA is organized under the laws of the State of Delaware and each MFC Partnership is formed under the laws of South Dakota. All of the assets of the MFC Partnerships are located outside of Canada and certain of the directors and officers, as well as certain of the experts named in this prospectus, are residents of the United States. As a result, it may be difficult or impossible for investors to effect service within Canada upon Medical Facilities USA, the MFC Partnerships or their directors, officers and experts who are not residents of Canada or to realize against them in Canada upon judgments of courts of Canada predicated upon the civil liability provisions of applicable Canadian provincial securities laws.

Medical Facilities USA and each MFC Partnership have been advised by counsel in the United States that there is some doubt as to the enforceability in the United States by a court in original actions, or in actions to enforce judgements of Canadian courts, of civil liabilities predicated upon such applicable Canadian provincial securities laws.

In addition, each MFC Partnership has agreed to indemnify the Issuer for breaches of representations and warranties given by them under the Investment Agreement. However, the indemnification obligations are limited as described under "Investment Agreement" and accordingly the Issuer may not be able to recover the full amount of any losses or damages suffered by it as a result of such breach to the detriment of the Issuer and ultimately holders of IPSs or Common Shares of the Issuer. Further, the Issuer indirectly owns 51% of each MFC Partnership which will further reduce any recovery. Finally, there can be no assurance that the MFC Partnerships will have sufficient assets to satisfy any indemnification liability.

***Investment Eligibility***

There can be no assurance that the Common Shares and Subordinated Notes represented by the IPSs will continue to be qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans under the Tax Act. The Tax Act imposes penalties for the acquisition or holding of non-qualified or ineligible investments.

On March 27, 2007 the Department of Finance (Canada) released revised draft legislation significantly modifying the income tax rules applicable to certain publicly listed or traded trusts and partnerships. An investment in IPSs does not involve a publicly listed or traded trust or partnership but an investment in IPSs shares certain characteristics with investments in publicly listed or traded trust or partnership entities that are the subject of the draft legislation and the proposals first announced on October 31, 2006. The proposals of October 31, 2006 indicated that although the details outlined therein reflected the then present intentions of the government, any aspect of these measures may be changed accordingly and possibly with retroactive effect if there should emerge structures or transactions that are clearly devised to frustrate the policy objectives underlying the proposals. Management believes that the proposed rules do not apply to the Company and do not alter the tax consequences of an investment in Common Shares and Subordinated Notes represented by IPSs. However, there is no assurance that the March 27, 2007 draft legislation and, more generally, Canadian federal income tax laws and administrative policies will not be changed in a manner that adversely affects the holders of Common Shares and Subordinated Notes represented by IPSs.

***U.S. Federal Income Tax Risks***

There can be no assurance that U.S. federal income tax laws and IRS administrative policies respecting the U.S. federal income tax consequences described in this prospectus will not be changed in a manner which adversely affects Non-U.S. Holders.

There is no authority that directly addresses the tax treatment of securities similar to the Subordinated Notes which are offered in circumstances similar to the IPO (i.e., as part of a unit that includes common shares of the issuer). In light of this absence of direct authority, it cannot be concluded with any certainty that the Subordinated Notes will be treated as debt for U.S. federal income tax purposes, and, although the Issuer intends to

take the position that the Subordinated Notes are debt for U.S. federal income tax purposes, there can be no assurance that this position will not be challenged by the IRS. If such a challenge were sustained, interest payments on the Subordinated Notes would be recharacterized as non-deductible distributions with respect to the Issuer's equity, and the Issuer's taxable income and U.S. federal income tax liability would be materially increased. As a result, the Issuer's after-tax cash flow would be reduced and the Issuer's ability to make interest payments on Subordinated Notes and distributions with respect to Common Shares would be materially and adversely impacted.

***Issuer May Not be Able to Make all Principal Payments on the Subordinated Notes***

The Subordinated Notes will mature ten years after the date of issuance unless the maturity is extended by the Issuer provided that certain conditions are met. The Issuer may not be able to refinance the principal amount of the Subordinated Notes in order to repay the principal outstanding or may not have generated enough cash from operations to meet this obligation. There is no guarantee that the Issuer will be able to repay the outstanding principal amount upon maturity of the Subordinated Notes.

As a result of the subordinated nature of the guarantees of the Subordinated Notes issued by the Issuer, upon any distribution to creditors of the MFC Partnerships in a bankruptcy, liquidation or reorganization or similar proceeding relating to the MFC Partnerships or their property or assets, the holders of such entities' senior indebtedness will be entitled to be paid in full in cash before any payment may be made with respect to the Subordinated Notes under the Subordinated Note Guarantees. In the event of a bankruptcy, liquidation or reorganization or similar proceeding relating to the MFC Partnerships, the holders of the Subordinated Notes and Subco Notes will participate (to the extent provided under the Subordinated Note Guarantee and Subco Guarantee) *pari passu* with all other holders of unsecured indebtedness and after the payment in full of the senior indebtedness. In any of these cases, there may not be sufficient funds to pay all of the MFC Partnerships' creditors and the holders of the Subordinated Notes may receive less, rateably than the holders of senior indebtedness.

On a consolidated basis as of December 31, 2006, the Subordinated Note Guarantees would have ranked subordinate to $24.6 million of outstanding senior indebtedness on a consolidated basis, all of which would have been secured.

***The Limited Cash Flow Guarantees Provided by each MFC Partnership May Not be Enforceable***

Each of the MFC Partnerships has provided a limited guarantee which effectively guarantees the distribution by that MFC Partnership of its proportionate share of the cash necessary to pay all interest on the Subordinated Notes issued hereunder. However, under United States federal bankruptcy law and comparable provisions of state fraudulent transfer laws, a guarantee can be voided, or claims in respect of a guarantee could be subordinated to all other debt of the guarantor, if, among other things, the guarantor, at the time that it assumed the guarantee:

- issued the guarantee to delay, hinder or defraud present or future creditors; or
- received less than reasonably equivalent value or fair consideration for issuing the guarantee and, at the time it issued the guarantee;
    - (a) was insolvent or rendered insolvent by reason of issuing the guarantee and the application of the proceeds of the guarantee;
    - (b) was engaged or about to engage in a business or a transaction for which the guarantor's remaining unencumbered assets constituted unreasonably small capital to carry on its business;
    - (c) intended to incur, or believed that it would incur, debts beyond its ability to pay the debts as they mature; or
    - (d) was a defendant in an action for money damages, or had a judgment for money damages docketed against it if, in either case, after final judgment, the judgment is unsatisfied.

In addition, any payment by the guarantor under its guarantee could be voided and required to be returned to the guarantor or to a fund for the benefit of the creditors of the guarantor or the guarantee could be subordinated to other debt of the guarantor.

The measures of insolvency for the purposes of fraudulent transfer laws vary depending upon the law applied in any proceeding to determine whether a fraudulent transfer has occurred. Generally, however, a person would be considered insolvent if, at the time it incurred the debt:

- the present fair saleable value of its assets was less than the amount that would be required to pay its probable liability on its existing debts, including contingent liabilities, as they become absolute and mature; or

- it could not pay its debts as they become due.

Although the Issuer does not believe that any of the MFC Partnerships are insolvent, the Issuer cannot be sure of the standard that a court would use to determine whether or not the MFC Partnerships were solvent at the relevant time, or, regardless of the standard that the court uses, that the issuance by them of the guarantees would not be voided or the guarantees would not be subordinated to the guarantors' other debt. If the guarantees are voided or subordinated to the guarantor's other debt, holders of the Subordinated Notes would be materially adversely effected in the event of a bankruptcy or insolvency of an MFC Partnership..

***The Non-Solicitation and Non-Competition Agreements of the Existing Partners May Not be Enforceable***

Each Subco, Holding Entity and member of each Holding Entity has entered into a non-solicitation and non-competition agreement in favour of the Issuer and Medical Facilities USA. The non-solicitation and non-competition agreements may not be enforceable under South Dakota law. As a general rule under South Dakota law non-solicitation and non-competition agreements are not enforceable, unless the agreement fits within a statutory exception, which statutory exceptions are narrowly construed. The Issuer can not provide any assurance that these agreements will be enforceable and if they are not enforceable, the Existing Partners could own and operate alternative surgical facilities in the markets where the MFC Hospitals are located which may materially adversely affect the operations and business of the MFC Partnerships.

***Holders of IPSs and Common Shares May Face Limited Liquidity***

The IPSs and the Common Shares have a limited public market history. A market in the United States or in Canada for IPSs or securities similar to IPSs has only been active for a limited period of time. No assurance can be made that an active trading market for the IPSs will be sustained in the future, and the Issuer currently does not expect that an active trading market for the Common Shares will develop until the Subordinated Notes mature. If the Subordinated Notes represented by the IPSs mature or are redeemed or repurchased, the IPSs will be automatically separated and an investor will then hold the Common Shares. The Subordinated Notes are not listed on any stock exchange.

***The Market Price for the IPSs, Common Shares or Subordinated Notes May be Volatile***

The market price for the IPSs may be subject to general volatility. Factors such as variations in the Issuer's financial results, announcements by the Issuer, the MFC Partnerships or others, developments affecting the business and customers, general interest rate levels, the market price of the Common Shares and general market volatility could cause the market price of the IPSs, the Common Shares or the Subordinated Notes to fluctuate significantly.

In addition, future sales or the availability for sale of substantial amounts of IPSs or Common Shares or a significant principal amount of Subordinated Notes in the public market could adversely affect the prevailing market price of the IPSs, the Common Shares and the Subordinated Notes and could impair the Issuer's ability to raise capital through future sales of its securities.

## MARKET FOR SECURITIES

The IPSs are listed and posted for trading on the Toronto Stock Exchange (the "**TSX**").

The monthly average volume of trading and price ranges of the IPSs on the TSX over fiscal 2006 are set forth in the following table:

| Period | High | Low | Volume |
|---|---|---|---|
| | $ | $ | |
| 2006 | | | |
| January | 12.15 | 11.20 | 44,053 |
| February | 12.00 | 11.30 | 52,236 |
| March | 11.94 | 10.28 | 46,824 |
| April | 11.23 | 9.96 | 44,866 |
| May | 10.11 | 8.41 | 55,287 |
| June | 9.50 | 8.50 | 41,428 |
| July | 9.44 | 8.94 | 66,441 |
| August | 9.94 | 9.17 | 29,565 |
| September | 9.64 | 8.90 | 36,069 |
| October | 9.60 | 8.81 | 76,112 |
| November | 9.45 | 8.01 | 80,585 |
| December | 9.20 | 8.42 | 103,149 |

## PROMOTERS

The MFC Original Partnerships are considered to be promoters of the Issuer by reason of their initiative in organizing the business and affairs of the Issuer.

## INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

To the knowledge of the Issuer, except as may be described elsewhere in this annual information form, no director, manager or executive officer of the Issuer or any of its subsidiaries, no person or company that is the director or indirect beneficial owner of, or who exercises control or direction over, more than 10% of any class or series of the outstanding voting securities of the Issuer and no associate or affiliate of any of the foregoing persons or companies, has or has had any material interest, direct or indirect, in any material transaction that has materially affected or will materially affect the Issuer since the Closing of the IPO on March 29, 2004.

## TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for the IPSs and the Common Shares is Computershare Investor Services Inc. at its office in Vancouver, British Columbia.

## MATERIAL CONTRACTS

The only material contracts, other than contracts entered into in the ordinary course of business, to which the Issuer, Medical Facilities USA or the MFC Partnerships are a party as at December 31, 2006 are the following:

In respect of the IPO:

- Investment Agreement ;
- Subordinated Note Indenture;
- Subordinated Note Guarantees and Subco Guarantees;

- Underwriting Agreement;
- Original Exchange Agreement;
- Non-solicitation and Non-competition Agreements;
- Operating Agreements in respect of Medical Facilities USA and for each Original Holding Entity;
- Partnership Agreements for each MFC Original Partnership;
- Subco Notes;
- Intercreditor Agreement; and
- the Credit Facilities.

In respect of the Subsequent Offering:

- OSH Subordinated Note Guarantee and OSH Subco Guarantee;
- First Supplemental Note Indenture;
- Subsequent Offering Underwriting Agreement;
- OSH Exchange Agreement;
- Non-solicitation and Non-competition Agreements;
- Operating Agreements in respect of OSH and its Subco and Holding Entity;
- OSH Subco Note;
- OSH Intercreditor Agreement; and
- OSH Credit Facility.

Each of these material contracts is specifically incorporated by reference herein and is available for review on SEDAR at www.sedar.com.

## LEGAL PROCEEDINGS

In the ordinary course of business, the Issuer, Medical Facilities USA and each MFC Partnership may, from time to time, be subject to various pending and threatened lawsuits in which claims for monetary damages are asserted. None of the Issuer, Medical Facilities USA, or the MFC Partnerships is involved in any legal proceedings which have a material effect on the Issuer. To the knowledge of Management, no legal proceedings of a material nature involving the Issuer, Medical Facilities USA or the MFC Partnerships have been pending or threatened by any individuals, entities or governmental authorities.

## INTERESTS OF EXPERTS

KPMG LLP, the Issuer's auditor, has been named as having prepared a certified statement, report or valuation described or included in a filing, or referred to in a filing, made under National Instrument 51-102 – Continuous Disclosure Obligations by the Issuer during, or relating to the Issuer's financial year ended

December 31, 2006. To the knowledge of the Issuer, KPMG LLP holds no registered or beneficial interest, directly or indirectly, in any securities or other property of the Issuer or any of its affiliates.

## ADDITIONAL INFORMATION

Additional information including directors' and officers' remuneration and indebtedness and the principal holders of the Issuer's securities, is contained in the Issuer's Management Information Circular dated March 22, 2007 relating to the annual meeting of shareholders of the Issuer to be held on May 11, 2007. Additional financial information is provided in the Issuer's financial statements and management's discussion and analysis of the Issuer's financial condition and results of operations for its most recently completed financial year. Copies of such documents and any additional information relating to the Issuer may be found on SEDAR at www.sedar.com. In the alternative, copies may be obtained from our Chief Financial Officer upon written request.

## SCHEDULE "A"
## AUDIT COMMITTEE CHARTER

### I. PURPOSE

1.1 The Audit Committee of Medical Facilities Corporation (the "Corporation") is appointed by the board of directors of the Corporation (the "Board") to assist the Board in its oversight of the Corporation's financial reporting process, including:

(a) The quality, objectivity and integrity of the financial reporting by the Corporation.

(b) The compliance by the Corporation with legal and regulatory requirements in respect of public financial disclosures.

(c) The qualifications, independence and performance of the Corporation's independent auditors.

(d) The integrity of the Corporation's financial reporting control processes and the performance of the Corporation's Chief Financial Officer on financial reporting matters.

(e) The review and approval of management's identification of principal financial risks and monitoring the processes which manage such risks.

1.2 The Audit Committee is to provide an avenue for free and open communication between the independent auditor, financial management, other employees and the Board concerning accounting and auditing matters.

The Audit Committee is directly responsible for the oversight of the relationship with the independent auditor, for recommending to the Board the nomination and compensation of the independent auditor and for the oversight of the performance and results of audit and audit related engagements.

1.3 The Audit Committee is not responsible for:

(f) Planning or conducting audits.

(g) Certifying or determining the completeness, fairness or accuracy of the Corporation's financial reporting or that the financial statements are in accordance with generally accepted accounting principles ("GAAP"). The fundamental responsibility for the Corporation's financial statements and financial disclosure rests with management.

(h) Guaranteeing the report of the Corporation's independent auditor.

(i) Conducting investigations, adjudicating disagreements (if any) between management and the independent auditor or ensuring compliance with applicable legal and regulatory requirements.

### II. REPORTS

2.1 The Audit Committee shall report to the Board on a regular basis and, in any event, before the public disclosure by the Corporation of its quarterly and annual financial results. The reports of the Audit Committee shall include any issues of which the Audit Committee is aware with respect to the quality or integrity of the Corporation's financial statements, its compliance with legal or regulatory requirements, and the performance and independence of the Corporation's independent auditor.

2.2 The Audit Committee shall also approve, as required by applicable law, any audit committee report required for inclusion in the Corporation's publicly filed documents, including this mandate.

## III. COMPOSITION

3.1 The members of the Audit Committee shall be three or more Board members who are appointed and may be removed by the Board on the recommendation of the Corporation's Compensation, Nominating and Corporate Governance Committee. The Chair of the Audit Committee shall be designated by the Board. Each member of the Audit Committee shall meet the independence and experience requirements of any directly relevant regulatory authority or stock exchange on which the Corporation is listed and, without limitation, shall be financially literate (or acquire such literacy within a reasonable period after appointment). A majority of the members of the Audit Committee shall be "resident Canadians", as contemplated by the *Business Corporations Act* (Ontario).

## IV. RESPONSIBILITIES

### 4.1 Independent Auditors

The Audit Committee shall:

(a) Recommend to the Board the appointment of the independent auditor.

(b) Obtain confirmation from the independent auditor that it ultimately is accountable, and will report directly, to the Board.

(c) Review and approve the independent auditors annual engagement letter and the proposals for related fees and review and discuss with the auditor the audit plans, the planned scope, areas of particular focus, materiality levels, the experience and qualifications of the senior members of the audit team and other matters of significance to the committee or auditor.

(d) Review all reports and recommendations from the independent auditor and help to resolve any disagreements between management and the independent auditor regarding financial reporting.

(e) Adopt policies and procedures for the pre-approval by the Audit Committee of the retention of the independent auditor by the Corporation and any of its subsidiaries for all audit and permitted non-audit services (subject to any regulatory restrictions on such services) including procedures for the delegation of authority to provide such approval to one or more members of the Audit Committee.

(f) At least annually, review the qualifications and independence of the independent auditor. In doing so, the Audit Committee should, among other things:

(i) review a report by the independent auditor describing: i) its internal quality-control procedures, ii) any material issues raised by recent firm-wide internal quality-control reviews, peer or professional body reviews of the independent auditor, iii) any material issues raised by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the independent auditor, iv) any steps taken to deal with issues identified in ii) and iii) above, and v) all relationships between the independent auditor and the Corporation; and

(ii) review periodic reports from the independent auditor regarding its independence and actively discuss with the auditor whether there are any non-audit services or relationships that may affect the objectivity and independence of the independent auditor and, if so, recommend that the Board take appropriate action to satisfy itself of the independence of the independent auditor.

### 4.2 Financial Statements and Related Financial Disclosures

The Audit Committee shall, as it determines to be appropriate:

(a) Review with management and, where appropriate, with the independent auditor:

(i) the Corporation's annual audited financial statements and quarterly financial statements and the Corporation's accompanying disclosure of Management's Discussion and Analysis and, in advance of public disclosure, make recommendations to the Board as to their approval and publication;

(ii) press releases which include financial information (such as earnings press releases), as well as financial information and any earnings guidance provided to analysts and rating agencies, recognizing that this review and discussion may be done generally (consisting of a discussion of the types of information to be disclosed and the types of presentations to be made) and need not always take place in advance of the disclosure of each release or provision of guidance;

(iii) any significant financial reporting issues, estimates and judgments made in connection with the preparation of the Corporation's financial statements, including any significant changes in the selection or application of accounting principles, any major issues regarding auditing principles and practices, and the adequacy of internal controls that could significantly affect the Corporation's financial reporting;

(iv) all critical accounting policies and practices used, including their application to unusual and material related party transactions;

(v) all alternative treatments of financial information within GAAP that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor;

(vi) the use of "pro forma" or "adjusted" or other non-GAAP information;

(vii) the effect of regulatory and accounting initiatives, as well as any off-balance sheet structures, transactions, arrangements and obligations (contingent or otherwise), on the Corporation's financial reports;

(viii) any disclosures concerning any weaknesses or any deficiencies in the design or operation of internal financial controls or disclosure controls made to the Audit Committee by the Chief Executive Officer and the Chief Financial Officer during their approval process for forms filed with applicable securities regulators;

(ix) the adequacy of the Corporation's internal accounting controls and its financial, auditing and accounting organizations and personnel and any special steps adopted in light of any material control deficiencies; and

(x) the Corporation's guidelines and policies with respect to risk assessment, the Corporation's major financial risk exposures and the steps management has taken to monitor and control such exposures.

(b) Review with the independent auditor:

(i) the quality, as well as the acceptability of the accounting principles that have been applied and of significant judgements made in estimating amounts;

(ii) accounting and or auditing issues related to the Corporation which were discussed by the auditors with their national office;

(iii) any problems or difficulties the independent auditor may have encountered during the provision of its audit-related services, including any restrictions on the scope of activities or access to requested information and any significant disagreements with management, any management letter provided by the independent auditor or other material

communication (including any schedules of unadjusted differences) to management and the Corporation's response to that letter or communication;

(iv) any changes to the Corporation's significant auditing and accounting principles and practices suggested by the independent auditor or other members of management;

(v) other matters required to be communicated to the Audit Committee under generally accepted auditing standards; and

(vi) the adequacy of procedures for the preparation of the Corporation's public disclosure of financial information extracted or derived from the Corporation's financial statements.

(c) Approve the hiring and/or the termination of the Chief Financial Officer, the chief internal auditor, if one is appointed, the mandates of such officers and generally review the adequacy of the human resources dedicated to financial and accounting functions.

**4.3 Compliance Procedures**

The Audit Committee shall, as it determines appropriate:

(a) Obtain reports from management and/or the independent auditor that the Corporation and its subsidiary/foreign affiliated entities are in conformity with applicable legal requirements including disclosures of insider and affiliated party transactions.

(b) Review with management and the independent auditor any correspondence with regulators or governmental agencies and any employee complaints or published reports, which raise material issues regarding the Corporation's financial statements or accounting policies.

(c) Advise the Board with respect to the Corporation's policies and procedures regarding compliance with applicable laws and regulations affecting financial reporting and compliance with internal policies relating to employee conduct, conflicts and integrity.

(d) Review with the Corporation's in-house or outside counsel legal matters that may have a material impact on financial statements, the Corporation's compliance policies and any material reports or inquiries received from regulators or governmental agencies.

(e) Review and approve the Corporation's hiring policies regarding partners, employees, and former partners and employees of the present and former external auditor of the Corporation.

(f) Establish procedures for:

(i) the receipt, retention and treatment of complaints regarding accounting, internal accounting controls or auditing matters; and

(ii) the confidential, anonymous submission by employees of the Corporation with concerns regarding any accounting or auditing matters.

(g) Review the expense accounts of senior officers of MFC and MFC (USA) as designated by the Board at least annually and the processes for their approval and reimbursement.

**4.4 Delegation**

To avoid any confusion, the Audit Committee responsibilities identified above are the responsibilities of the Audit Committee and may not be allocated to a different committee.

## V. MEETINGS

5.1 The Audit Committee shall meet at least quarterly and more frequently as circumstances require. A quorum will consist of a majority of the members present in person or by telephone and all decisions of the Committee require a majority of those present at a meeting of the Committee at which a quorum is present.

5.2 Minutes shall be maintained for all meetings together with materials relating to those meetings and copies will be provided to the Board

5.3 Periodically, the Audit Committee shall meet separately with management, the independent auditors and any internal auditor. At its own discretion, the Committee may request any officer or employee of the Corporation or the Corporation's outside counsel or independent auditor to attend meetings of the Audit Committee or with any members of, or advisors to, the Audit Committee.

5.4 Except as otherwise provided above, the Audit Committee may form and delegate authority to individual members and/or subcommittees where the Audit Committee determines it is appropriate to do so. All matters dealt with by delegation shall be promptly reported to the full committee, no later than the subsequent meeting of the full committee.

## VI. INDEPENDENT ADVICE

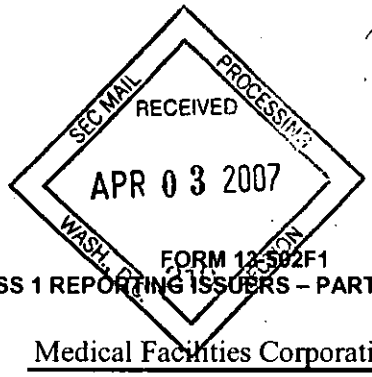
6.1 In discharging its mandate, the Audit Committee shall have the authority to retain and compensate, at the expense of the Corporation, special legal, accounting or other advisors as the Audit Committee, in its sole discretion, determines to be necessary to permit it to carry out its duties.

## VII. ANNUAL EVALUATION

7.1 At least annually, the Audit Committee shall, in a manner it determines to be appropriate:

(a) Perform a review and evaluation of the performance of the Audit Committee and its members, including the compliance of the Audit Committee with this charter.

(b) Review and assess the adequacy of its charter and recommend to the Board any improvements to this charter that the Audit Committee determines to be appropriate.

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**FORM 13-502F1**
**CLASS 1 REPORTING ISSUERS – PARTICIPATION FEE**

**Reporting Issuer Name:** Medical Facilities Corporation

**Fiscal year end date used to calculate capitalization:** December 31, 2006

Market value of listed or quoted securities:

Total number of securities of a class or series outstanding as at the issuer's most recent fiscal year end — 28,011,535(i)

Simple average of the closing price of that class or series as of the last trading day of each month of the fiscal year (See clauses 2.11(a)(ii)(A) and (B) of the Rule) — $9.90(ii)

Market value of class or series — (i) X (ii) =$277,314,197 (A)

(Repeat the above calculation for each class or series of securities of the reporting issuer that was listed or quoted on a marketplace in Canada or the United States of America at the end of the fiscal year) — (B)

Market value of other securities:

(See paragraph 2.11(b) of the Rule)

(Provide details of how value was determined) — (C)

(Repeat for each class or series of securities) — (D)

**Capitalization**

(Add market value of all classes and series of securities) — (A) + (B) + (C) + (D) =

**Participation Fee**

(From Appendix A of the Rule, select the participation fee beside the capitalization calculated above) — $14,700

**New reporting issuer's reduced participation fee**, if applicable

(See section 2.6 of the Rule)

$$\frac{\text{Participation fee} \times \text{Number of entire months remaining in the issuer's fiscal year}}{12} =$$

**Late Fee**, if applicable

(As determined under section 2.5 of the Rule)

MEDICAL FACILITIES CORPORATION

# MANAGEMENT'S DISCUSSION AND ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE THREE-MONTH AND THE TWELVE-MONTH PERIOD ENDED DECEMBER 31, 2006

March 22, 2007

*The information in this Management's Discussion and Analysis ("MD&A") is supplemental to, and should be read in conjunction with, the consolidated financial statements of Medical Facilities Corporation (the "Corporation") for the twelve-month period ended December 31, 2006, which financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Substantially all of the Corporation's operating cash flows are in US dollars and all amounts presented herein are stated in US dollars, unless indicated otherwise.*

*This discussion and analysis contains forward-looking statements. Such statements involve known and unknown risks, uncertainties and other factors outside of management's control that could cause actual results to differ materially from those described in the forward-looking statements. The Corporation does not assume responsibility for the accuracy and completeness of these forward-looking statements and does not undertake the obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.*

*This discussion also makes reference to certain non-GAAP measures to assist in assessing the Corporation's financial performance. Non-GAAP earnings measures do not have any standard meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers.*

*Additional information about and the Annual Information Form filed by the Corporation are available on SEDAR at www.sedar.com or the Corporation's website at www.medicalfacilitiescorp.com.*

This Management's Discussion and Analysis is presented in the following sections:

- **Corporate Overview**
- **Non-GAAP Financial Measure – Cash Available for Distribution**
- **Condensed Consolidated Financial Highlights**
- **Operating and Financial Results of the Centers**
- **Liquidity and Financial Condition**
- **Financial Instruments**
- **Related Party Transactions**
- **Critical Accounting Estimates**
- **Management's Responsibility for Financial Reporting and Disclosure Controls**
- **Risk Factors**
- **Outlook**

## CORPORATE OVERVIEW

The Corporation is a British Columbia corporation and is subject to corporate taxation in both Canada and the United States. The Corporation, through its wholly-owned U.S. subsidiary, owns controlling interests in and derives substantially all of its income from, four limited liability entities (the "Centers"), each of which owns a specialty surgical hospital, three located in South Dakota and one in Oklahoma. The four Centers provide facilities (including staff, support, and supplies) for scheduled surgical, pain management, imaging and diagnostic procedures and derive their revenue primarily from the fees charged for the use of these facilities.

## NON-GAAP FINANCIAL MEASURE – CASH AVAILABLE FOR DISTRIBUTION

The Corporation distributes a substantial majority of its free cash flows from operations in the United States to holders of its Income Participating Securities ("IPS"), with a portion of such distributions being interest payments on its subordinated notes and a portion being dividends on its common shares. The Corporation believes that cash available for distribution on its IPS provides a useful measure for evaluation of the Corporation's performance. In particular, the Corporation believes that investors should be able to ascertain the extent to which the distributions are funded by operations as discussed below.

Cash available for distribution is a non-GAAP measure and is not intended to be representative of cash flow or results of operations determined in accordance with GAAP. Accordingly, the Corporation provides a reconciliation of cash available for distributions to cash provided by operating activities. Investors are cautioned that cash available for distribution, as calculated by the Corporation, is unlikely to be comparable to similar measures used by other issuers.

The major differences between cash available for distribution, which is not a defined term under Canadian GAAP, and cash provided by operating activities as reported in the Corporation's financial statements are:

1) Interest on the subordinated notes;

2) Changes in the non-cash operating working capital for the period;

3) Losses (gains) on the cash balances denominated in Cdn$;

4) Minority interest in the cash flow of the Centers generated in the respective periods;

5) Repayment of non revolving debt at the Centers' level; and

6) Maintenance capital expenditures.

*Reconciliation of cash available for distribution to the cash flows from operating activities*

| | | Three Months Ended December 31, 2006 ($'000s) (unaudited) | Three Months Ended December 31, 2005 ($'000s) (unaudited) restated | Twelve Months Ended December 31, 2006 ($'000s) (unaudited) | Twelve Months Ended December 31, 2005 ($'000s) (unaudited) restated |
|---|---|---|---|---|---|
| **CASH PROVIDED BY OPERATING ACTIVITIES** | | **9,609** | **7,637** | **41,949** | **35,273** |
| Add: | | | | | |
| Interest expense (net of interest income) | | 4,813 | 4,645 | 19,343 | 16,739 |
| Change in non-cash operating working capital | | 3,325 | 3,219 | 2,316 | 1,483 |
| Unrealized loss on foreign currency on cash balances denominated in Cdn$ | | 405 | - | 78 | - |
| | | **18,152** | **15,501** | **63,686** | **53,495** |
| Less: | | | | | |
| Minority interest in cash flow of Centers | | (8,138) | (6,728) | (27,777) | (23,848) |
| Interest expense (other than on subordinated notes) | | (266) | (239) | (1,103) | (1,182) |
| Unrealized gain on foreign currency on cash balances denominated in Cdn$ | | - | (2) | - | (375) |
| Repayment of debt (non revolving) | | (274) | (227) | (1,075) | (615) |
| Maintenance capital expenditures | | (674) | (728) | (1,977) | (1,829) |
| **CASH AVAILABLE FOR DISTRIBUTIONS ON IPS** | **USD** | **8,800** | **7,577** | **31,754** | **25,646** |
| Average exchange rate of Cdn$ to US$ for the period. | | 1.1378 | 1.1823 | 1.1342 | 1,2117 |
| **CASH AVAILABLE FOR DISTRIBUTIONS ON IPS** | **CDN** | **10,013** | **8,958** | **36,016** | **31,074** |
| **PER IPS UNIT[1]** | **CDN** | **$ 0.357** | **$ 0.320** | **$ 1.286** | **$ 1.233** |
| **TOTAL DISTRIBUTIONS** | | | | | |
| Interest on subordinated notes | CDN | 5,168 | 5,168 | 20,673 | 18,800 |
| Dividends on common shares | CDN | 2,538 | 2,538 | 10,151 | 9,232 |
| | CDN | 7,706 | 7,706 | 30,824 | 28,032 |
| **PER IPS UNIT[1]** | **CDN** | **$ 0.275** | **$ 0.275** | **$ 1.100** | **$ 1.113** |

*Note 1: Calculated based on the weighted average number of IPS outstanding.*

In the three-month period ended December 31, 2006, the Corporation generated cash available for distribution of Cdn$10.0 million, which exceeded distributions declared in respect of this period by Cdn$2.3 million. On a per IPS basis, cash available for distribution was Cdn$0.357 or 29.81% higher than distributions declared of Cdn$0.275, resulting in a payout ratio of 76.96% (2005 85.94%).

In the twelve-month period ended December 31, 2006, the Corporation generated cash available for distribution of Cdn$36.0 million, which exceeded distributions declared in respect of this period by Cdn$5.2 million. On a per IPS basis, cash available for distribution was Cdn$1.286 or 16.90% higher than distributions declared of Cdn$1.100, resulting in a payout ratio of 85.54% (2005 90.26%).

## CONDENSED CONSOLIDATED FINANCIAL HIGHLIGHTS

| 2006 | 1st Q 2006 Restated ($'000s) (unaudited | 2nd Q 2006 Restated ($'000s) (unaudited | 3d Q 2006 ($'000s) (unaudited | 4th Q 2006 ($'000s) (unaudited) | Twelve Months Ended Dec 31, 2006 ($'000s) |
|---|---|---|---|---|---|
| NET PATIENT SERVICE REVENUES | 36,129 | 36,063 | 34,362 | 41,983 | 148,537 |
| EXPENSES | 21,152 | 21,626 | 20,750 | 24,660 | 88,188 |
| DEPRECIATION AND AMORTIZATION | 2,889 | 2,909 | 3,775 | 3,320 | 12,894 |
| INTEREST EXPENSE, NET | 4,883 | 5,034 | 4,988 | 4,947 | 19,852 |
| MINORITY INTEREST | 6,811 | 6,459 | 6,057 | 8,100 | 27,427 |
| NET PROFIT (LOSS) BEFORE GAIN (LOSS) ON FOREIGN CURRENCY AND TAX BENEFIT (EXPENSE) | 394 | 35 | (1,208) | 956 | 177 |
| GAIN (LOSS) ON FOREIGN CURRENCY. | (772) | (2,907) | 96 | 3,329 | (254) |
| INCOME TAX EXPENSE | 695 | (1,070) | (665) | 1,135 | 95 |
| **NET PROFIT (LOSS) FOR THE PERIOD** | **317** | **(3,942)** | **(1,777)** | **5,420** | **18** |
| **BASIC & FULLY DILUTED INCOME (LOSS) PER SHARE** | **$ 0.011** | **$ (0.141)** | **$ (0.063)** | **$ 0.194** | **$ 0.001** |

| 2005 | 1st Q 2005 Restated ($'000s) (unaudited) | 2nd Q 2005 Restated ($'000s) (unaudited) | 3rd Q 2005 Restated ($'000s) (unaudited) | 4th Q 2005 Restated ($'000s) (unaudited) | Twelve Months Ended Dec 31, 2005 Restated ($'000s) |
|---|---|---|---|---|---|
| NET PATIENT SERVICE REVENUES | 25,426 | 25,082 | 34,403 | 37,052 | 121,963 |
| EXPENSES | 14,005 | 13,993 | 20,785 | 22,317 | 71,100 |
| DEPRECIATION AND AMORTIZATION | 2,458 | 2,476 | 2,921 | 3,525 | 11,380 |
| INTEREST EXPENSE, NET | 3,629 | 3,921 | 4,781 | 4,774 | 17,105 |
| MINORITY INTEREST | 5,243 | 5,049 | 6,275 | 6,734 | 23,301 |
| NET PROFIT (LOSS) BEFORE GAIN (LOSS) ON FOREIGN CURRENCY AND TAX BENEFIT (EXPENSE) | 91 | (357) | (359) | (298) | (923) |
| GAIN (LOSS) ON FOREIGN CURRENCY | 144 | (44) | (2,820) | 999 | (1,721) |
| INCOME TAX RECOVERY (EXPENSE) | 246 | 504 | (1,419) | (190) | (859) |
| **NET PROFIT (LOSS) FOR THE PERIOD** | **481** | **103** | **(4,598)** | **511** | **(3,503)** |
| **BASIC & FULLY DILUTED INCOME (LOSS) PER SHARE** | **$ 0.022** | **$ 0.004** | **$ (0.166)** | **$ 0.018** | **$ (0.139)** |

*Note 1: Results of OSH are included from the date of its acquisition, June 21, 2005.*

***Three months ended December 31, 2006 compared to three months ended December 31, 2005***

Consolidated net patient service revenues ("net revenues") for the three months ended December 31, 2006 totaled $42.0 million, which exceeded the same period in 2005 by $4.9 million or 13.3%. While net patient service revenues at the original Centers located in South Dakota increased by 19.9% on stronger case volume and favorable case mix, net patient service revenues for Oklahoma Spine Hospital ("OSH") decreased by 1.6% reflecting a decrease in the number of pain management procedures performed, and

the continued effect of a change in reimbursement rates from one of the payors and a slightly less favorable payor mix.

Consolidated expenses, including salaries and benefits, drugs and supplies, and general and administrative costs increased $2.3 million or 10.5% compared to the same period in 2005. Expenses for the original three Centers for the three months ended December 31, 2006 increased by $1.6 million or 11.0% compared to the same period in 2005. This increase in operating expenses is largely due to an increase in the number of cases requiring more drugs and supplies, as well as annual wage and salary adjustments and higher employee health insurance premiums. The operating expenses at OSH increased by $0.3 million largely due to annual wage and salary adjustments and higher employee health insurance premiums, as well as higher repair and maintenance costs. Parent company expenses increased by $0.4 million compared to prior year, mostly due to higher costs related to the public company structure and management bonuses.

Operating income (before depreciation and amortization, interest expense, loss on foreign currency translation and minority interest) of $17.3 million for the three months ended December 31, 2006 exceeded the operating income for the same period a year earlier by $2.6 million or 17.7% reflecting improved performance at the South Dakota Centers, offset by a weaker performance at OSH.

Net interest expense consists primarily of interest on the subordinated notes and credit facilities of the Centers, offset by the interest earned on the excess cash balances held by the Corporation. The decrease in net interest expense for the three months ended December 31, 2006 compared to the same period in 2005 is mainly attributable to increased interest income earned on excess cash balances.

The Corporation maintains a portion of its cash balances in Canadian dollars and its subordinated notes payable are denominated in Canadian dollars. The financial statements of the Corporation are expressed in US dollars and include cash balances in Canadian dollars and subordinated notes payable translated into US dollars at the rate of exchange in effect at the balance sheet date. The unrealized foreign currency gains and losses resulting from translation of these items arise from changes in the exchange rate between the Canadian and US dollars during the respective periods.

***Twelve months ended December 31, 2006 compared to twelve months ended December 31, 2005***

Net revenues for the twelve months ended December 31, 2006 totaled $148.5 million, up 21.8% or $26.6 million over the same period in 2005. Results for 2006 include twelve months of net revenue ($42.0 million) from OSH, whereas 2005 only included net revenue ($24.1 million) for the period from OSH's acquisition by the Corporation on June 21, 2005. Net revenues for the original Centers increased by $8.7 million or 8.9% compared to the same period in 2005. This increase reflects general price increases, a favorable mix of higher revenue generating cases and an increased number of cases at the South Dakota Centers. Consolidated expenses, including salaries and benefits, drugs and supplies, and general and administrative costs increased by 24.1% or $17.1 million over 2005 to $88.2 million in 2006, of which $14.4 million is attributable to the inclusion of operations of OSH for the full twelve months in 2006 compared to the period from June 21, 2005 to December 31, 2005. Expenses for the original three Centers for the twelve months ended December 31, 2006 increased by $2.4 million or 4.5% compared to the same period in 2005. This increase in operating expenses is mainly due to annual wages and salary adjustments and higher health insurance premiums as compared to 2005.

Operating income (before depreciation and amortization, interest expense, loss on foreign currency translation and minority interest) for the twelve months ended December 31, 2006 was $60.1 million, up 18.8% from $50.6 million a year earlier. Of the $9.5 million increase, $6.3 reflects the results of the original three Centers, excluding OSH.

Net interest expense consists primarily of interest on the subordinated notes and credit facilities of the Centers, offset by the interest earned on the excess cash balances held by the Corporation. The increase in net interest expense for the twelve months ended December 31, 2006 compared to the same period in 2005 is mainly attributable to the additional IPS units issued in June and September 2005.

## OPERATING AND FINANCIAL RESULTS OF THE CENTERS

Performance of the Corporation and its ability to make distributions to its unitholders depends on the combined performance of the Centers, in which it holds an interest and from which it receives monthly cash distributions. Therefore, in order to enhance its usefulness, this management discussion and analysis includes a summary of the operating results of each of the four Centers for the three months and twelve months ended December 31, 2006 compared to the three months and twelve months ended December 31, 2005. Operating results of OSH for the period from January 1 to June 20, 2005 are included for comparative purposes only. As the Corporation completed the acquisition of a 51% interest in OSH on June 21, 2005, its results prior to the acquisition date are not included in the consolidated results of the Corporation for 2005.

| | Three Months Ended December 31, 2006 (unaudited) | | Three Months Ended December 31, 2005 (unaudited) | | % Change |
|---|---|---|---|---|---|
| | ($'000s) | % of Net Revenues | ($'000s) | % of Net Revenues | |
| ***Net revenues:*** | | | | | |
| Black Hills Surgery Center, LLP | 14,719 | | 11,523 | | 27.7% |
| Sioux Falls Surgical Center, LLP | 13,281 | | 11,477 | | 15.7% |
| Dakota Plains Surgical Center, LLP | 2,738 | | 2,628 | | 4.2% |
| Oklahoma Spine Hospital, LLC | 11,245 | | 11,424 | | (1.6%) |
| ***Salaries and benefits:*** | | | | | |
| Black Hills Surgery Center, LLP | 3,247 | 22.1% | 2,993 | 26.0% | 8.5% |
| Sioux Falls Surgical Center, LLP | 2,675 | 20.1% | 2,351 | 20.5% | 13.8% |
| Dakota Plains Surgical Center, LLP | 568 | 20.7% | 635 | 24.2% | (10.6%) |
| Oklahoma Spine Hospital, LLC | 2,290 | 20.4% | 2,100 | 18.4% | 9.1% |
| ***Drugs and supplies:*** | | | | | |
| Black Hills Surgery Center, LLP | 2,227 | 15.1% | 1,919 | 16.7% | 16.1% |
| Sioux Falls Surgical Center, LLP | 2,810 | 21.2% | 2,303 | 20.1% | 22.0% |
| Dakota Plains Surgical Center, LLP | 576 | 21.0% | 728 | 27.7% | (21.0%) |
| Oklahoma Spine Hospital, LLC | 3,552 | 31.6% | 3,068 | 26.9% | 15.8% |
| ***General, administrative and other operating:*** | | | | | |
| Black Hills Surgery Center, LLP | 1,824 | 12.4% | 1,661 | 14.4% | 9.8% |
| Sioux Falls Surgical Center, LLP | 1,333 | 10.0% | 1,165 | 10.2% | 14.4% |
| Dakota Plains Surgical Center, LLP | 429 | 15.7% | 385 | 14.7% | 11.5% |
| Oklahoma Spine Hospital, LLC | 2,081 | 18.5% | 2,452 | 21.5% | (15.1%) |
| ***Income (loss) before interest expense, depreciation & amortization, and other expenses:*** | | | | | |
| Black Hills Surgery Center, LLP | 7,422 | 50.4% | 4,950 | 43.0% | 49.9% |
| Sioux Falls Surgical Center, LLP | 6,463 | 48.7% | 5,658 | 49.3% | 14.2% |
| Dakota Plains Surgical Center, LLP | 1,166 | 42.6% | 880 | 33.5% | 32.5% |
| Oklahoma Spine Hospital, LLC | 3,322 | 29.5% | 3,804 | 33.3% | (12.7%) |

The changes in the components of operating results as shown in the preceding table are discussed below Center by Center.

***Black Hills Surgery Center, LLP (52.95% ownership interest)***

Net revenues for the three months ended December 31, 2006 increased by 27.7% over the corresponding period in 2005, primarily due to a 14% increase in the number of cases performed and growth in the number of larger and more complex cases. Salaries and benefits increased by 8.5% primarily due to annual wage and salary adjustments and an increase in payroll costs to accommodate the increased caseload. The cost of drugs and supplies, as a percentage of net revenues, decreased to 15.1% from 16.7% a year earlier, primarily due to changes in the types of surgeries performed and cost reductions for certain surgical implants. General, administrative and other operating expenses for the three months ended December 31, 2006 increased by 9.8% compared to the same period in 2005, primarily due to bad debt expense which returned to more normal levels than that experienced in 2005, increased equipment maintenance costs and radiology reading fees incurred due to increased MRI volume.

***Sioux Falls Surgical Center, LLP (51.00% ownership interest)***

Net revenues for the fourth quarter of 2006 were up 15.7% over the same period in 2005, primarily due to fee increases, a 5.4% increase in the number of cases performed and a favorable shift in the proportion of higher revenue generating cases. Salaries and benefits for the three months ended December 31, 2006 increased by 13.8% compared to the same period in 2005, primarily as a result of the growth in the number of cases performed and bonuses due to improved performance. The cost of drugs and supplies, as a percentage of net revenues, increased to 21.2% from 20.1% a year earlier, due to a higher proportion of complex cases that incur higher costs of supplies and implants. General, administrative and other operating expenses for the three months ended December 31, 2006 increased by 14.4%, primarily due to bad debt expense, charity care expense, and a non-recurring marketing expenditure for an expanded sports medicine program.

***Dakota Plains Surgical Center, LLP (51.00% ownership interest)***

Net revenues for the fourth quarter of 2006 increased by 4.2% over the same period in 2005, primarily due to a growth in the number of higher revenue generating spine cases and a more favorable payor mix, while the number of cases performed decreased slightly. The cost of drugs and supplies, as a percentage of net revenues, decreased to 21.0% from 27.7% a year earlier, primarily due to a decrease in the number of higher cost hip and knee implants.

***Oklahoma Spine Hospital, LLC (51.00% ownership interest)***

Net revenues for the three months ended December 31, 2006 decreased by 1.6% compared to the same period in 2005 due to a 4.6% decrease in pain management revenue, a less complex surgical case mix, and a reduction in reimbursement rates received from a non-contracted payor that became effective in January 2006, which were partially offset by a 7.0% increase in the number of surgical cases performed. Salaries and benefits for the three months ended December 31, 2006 increased by 9.1% due to annual wage and salary adjustments and higher employee health insurance premiums. The cost of drugs and supplies increased 15.8% from the same period in 2005 due to an increased number of surgical cases. As a percentage of net revenues, drugs and supplies costs increased to 31.6% from 26.9% a year earlier due to a decrease in the number of pain management procedures performed that incur significantly lower costs of supplies compared to the surgical cases. General, administrative and other operating expenses for the three months ended December 31, 2006 decreased by 15.1% compared to the same period in 2005 due to a decrease in a bad debt expense, as well as a decrease in administrative and accounting fees.

| | Twelve months Ended December 31, 2006 (unaudited) | | Twelve Months Ended December 31, 2005[1] (unaudited) | | % Change |
|---|---|---|---|---|---|
| | ($'000s) | % of Net Revenues | ($'000s) | % of Net Revenues | |
| ***Net revenues:*** | | | | | |
| Black Hills Surgery Center, LLP | 49,338 | | 47,174 | | 4.6% |
| Sioux Falls Surgical Center, LLP | 47,459 | | 41,218 | | 15.1% |
| Dakota Plains Surgical Center, LLP | 9,752 | | 9,488 | | 2.8% |
| Oklahoma Spine Hospital, LLC | 41,988 | | 45,879 | | (8.5%) |
| ***Salaries and benefits:*** | | | | | |
| Black Hills Surgery Center, LLP | 12,162 | 24.7% | 11,687 | 24.8% | 4.1% |
| Sioux Falls Surgical Center, LLP | 9,373 | 19.7% | 8,950 | 21.7% | 4.7% |
| Dakota Plains Surgical Center, LLP | 2,400 | 24.6% | 2,743 | 28.9% | (12.5%) |
| Oklahoma Spine Hospital, LLC | 8,779 | 20.9% | 8,375 | 18.3% | 4.8% |
| ***Drugs and supplies:*** | | | | | |
| Black Hills Surgery Center, LLP | 7,351 | 14.9% | 7,731 | 16.4% | (4.9%) |
| Sioux Falls Surgical Center, LLP | 9,303 | 19.6% | 7,437 | 18.0% | 25.1% |
| Dakota Plains Surgical Center, LLP | 2,188 | 22.4% | 2,424 | 25.5% | (9.7%) |
| Oklahoma Spine Hospital, LLC | 12,557 | 29.9% | 12,810 | 27.9% | (2.0%) |
| ***General, administrative and other operating:*** | | | | | |
| Black Hills Surgery Center, LLP | 6,179 | 12.5% | 5,931 | 12.6% | 4.2% |
| Sioux Falls Surgical Center, LLP | 4,819 | 10.2% | 4,621 | 11.2% | 4.3% |
| Dakota Plains Surgical Center, LLP | 1,583 | 16.2% | 1,460 | 15.4% | 8.4% |
| Oklahoma Spine Hospital, LLC | 9,044 | 21.5% | 10,192 | 22.2% | (11.3%) |
| ***Income (loss) before interest expense, depreciation & amortization, and other expenses:*** | | | | | |
| Black Hills Surgery Center, LLP | 23,646 | 47.9% | 21,825 | 46.3% | 8.3% |
| Sioux Falls Surgical Center, LLP | 23,964 | 50.5% | 20,210 | 49.0% | 18.6% |
| Dakota Plains Surgical Center, LLP | 3,582 | 36.7% | 2,861 | 30.2% | 25.2% |
| Oklahoma Spine Hospital, LLC | 11,609 | 27.6% | 14,502 | 31.6% | (20.0%) |

*Note 1: Amounts for the twelve months ended December 31, 2005 include the historical results of OSH prior to the acquisition by the Corporation of a 51% ownership of the Center on June 21, 2005.*

The changes in the components of operating results as shown in the preceding table are discussed below Center by Center.

***Black Hills Surgery Center, LLP (52.95% ownership interest)***

Net revenues for the twelve months ended December 31, 2006 increased by 4.6% over the corresponding period in 2005, primarily due to a 2.8% increase in the number of cases performed. Salaries and benefits increased by 4.1%, primarily reflecting annual wage and salary adjustments. The cost of drugs and supplies, as a percentage of net revenues, decreased to 14.9% from 16.4% a year earlier, primarily due to changes in the types of surgeries performed and cost reductions for certain surgical implants. General, administrative and other operating expenses for the twelve months ended December 31, 2006 increased by 4.2% compared to the same period in 2005, primarily due to an increase in bad debt expense.

***Sioux Falls Surgical Center, LLP (51.00% ownership interest)***

Net revenues for the twelve months ended December 31, 2006 were up 15.1 % over the same period in 2005, primarily due to fee increases, a 5.7% increase in the number of cases performed, and a favorable shift towards more complex, higher revenue generating cases. Salaries and benefits increased by 4.7% primarily due to annual wage and salary adjustments, performance bonuses and an increase in staffing related to the increased caseload. The cost of drugs and supplies, as a percentage of net revenues, increased to 19.6% from 18.0% in 2005 due to a higher proportion of complex cases that incur higher costs of supplies and implants. General, administrative and other operating expenses for the twelve months ended December 31, 2006 increased by 4.3% compared to the same period in 2005, due primarily to increased bad debt expense and charity care.

***Dakota Plains Surgical Center, LLP (51.00% ownership interest)***

Net revenues for the twelve months ended December 31, 2006 increased by 2.8% over the same period in 2005, mainly due to annual fee increases. Salaries and benefits decreased by 12.5% over a year earlier as nurse anesthetists previously employed by DPSC are now part of an independent provider practice that bills patients directly. The cost of drugs and supplies, as a percentage of net revenues, decreased to 22.4% from 25.5% in 2005, primarily due to a lower proportion of inpatient cases that incur higher costs of drugs and supplies.

***Oklahoma Spine Hospital, LLC (51.00% ownership interest)***

Net revenues for the twelve months ended December 31, 2006 decreased 8.5% as compared to 2005 due to a 4.6% decrease in the number of cases performed, and a reduction in reimbursement rates paid by a certain non-contracted payor effective January 2006 and a less favorable payor mix. Salaries and benefits increased by 4.8% over the corresponding period in 2005, primarily due to annual wage and salary adjustments and higher employee health insurance premiums. The cost of drugs and supplies decreased 2.0% from the same period in 2005 consistent with the decrease in revenue and number of cases. As a percent of net revenues, drugs and supplies cost increased to 29.9% from 27.9% a year earlier due to the decline in the reimbursement rates. The decrease in general and administrative expense is due to a decrease in bad debt expense, as well as a decrease in administrative and accounting fees.

## LIQUIDITY, CAPITAL RESOURCES AND FINANCIAL CONDITION

The Corporation is dependent upon cash generated from operating activities of the Centers, which is the source of financing for its operations and for meeting its contractual obligations. The Centers distribute, on a monthly basis, substantially all of their cash flows to the Corporation and the minority partnership interests. A reconciliation of cash provided by operating activities as reported to cash available for distribution is presented in the section Non-GAAP Financial Measure – Cash Available for Distribution.

Dividend declarations are determined based on monthly reviews of the Corporation's earnings, capital expenditures and related cash flows. Such declarations take into account the Corporation's structure whereby available cash is to be distributed to the maximum extent considered prudent after (i) interest on the subordinated notes, (ii) other debt service obligations, (iii) other expense and tax obligations, and (iv) reasonable reserves for working capital, collateral for hedge contracts and capital expenditures.

As at December 31, 2006, the Corporation had net working capital of $38.6 million, including cash balances of $15.4 million and patient accounts receivables of $27.7 million. Accounts payable and accrued liabilities totaled $9.7 million. Total assets at December 31, 2006 were $258.7 million and total long-term liabilities were $164.5 million. Cash distributions declared in the period from January 1, 2006 to December 31, 2006 totaled Cdn$1.100 per IPS.

The Centers have in place credit facilities and notes payable in an aggregate amount of $36.8 million, of which $22.5 million was utilized as at December 31, 2006. The balances available under the credit facilities, combined with cash on hand as at December 31, 2006, are available to manage the Corporation's accounts receivable, inventory and other short-term cash requirements, including funding of US withholding taxes.

The Corporation's subordinated notes payable are denominated in Canadian dollars and are reflected in the financial statements in US dollars at the rate of exchange in effect at the balance sheet date. These subordinated notes will mature on March 29, 2014, subject to the Corporation's right to extend their maturity for two additional successive five year terms provided certain conditions are satisfied at such times.

The following table sets out the mandatory repayments due under the credit facilities, notes payable and other contractual obligations:

| Contractual Obligations | Total | Less than 1 year | 2-3 years | 4-5 years | After 5 years |
|---|---|---|---|---|---|
| | | | *(US$ thousands)* | | |
| Revolving Credit Facilities | 9,336 | - | 3,233 | 6,103 | - |
| Notes Payable & Term Loan | 14,927 | 1,506 | 3,769 | 9,652 | - |
| Capital Lease Obligation | 306 | 226 | 80 | - | - |
| Operating Leases & Commitments | 15,529 | 2,413 | 4,422 | 3,972 | 4,722 |
| IPS Subordinated Notes Payable | 141,711 | - | - | - | 141,711 |
| **Total Contractual Obligations** | **$181,809** | **$4,145** | **$11,504** | **$19,727** | **$146,433** |

The Corporation expects to be able to renew or refinance the various credit facilities as they come due at then current market rates.

## FINANCIAL INSTRUMENTS

The Corporation enters into forward foreign exchange contracts to manage the Corporation's exposure to fluctuations in the exchange rate between US and Canadian currencies, which exposure arises from payment of interest and dividends on its IPS and payment of certain corporate expenses being made in Canadian dollars.

As at December 31, 2006, the Corporation is committed to deliver between $2.0 and $2.5 million US dollars monthly through February 2010 in exchange for Canadian dollars at the stipulated exchange rates as follows:

| Contract Dates | US$ to be delivered *($millions)* | Cdn$ to be received *($millions)* | Cdn$ per US$ *(Weighted Average)* |
|---|---|---|---|
| Jan 2007 – Dec 2007 | 24.0 | 30.6 | 1.2750 |
| Jan 2008 – Dec 2008 | 25.7 | 30.4 | 1.1829 |
| Jan 2009 – Feb 2010 | 33.3 | 37.1 | 1.1141 |
| | 83.0 | 98.1 | |

The fair value of the outstanding contracts as at December 31, 2006 was $2.4 million and is reflected as an asset in the financial statements while changes in the fair value during each reporting period are recorded as unrealized gains (losses) in the income statement. It is the Corporation's intention to maintain these contracts in place until their scheduled maturity dates, at which time gains (losses) on the matured contracts are reflected in the consolidated income statement.

The Corporation has provided collateral in the amount of $4.5 million US dollars to secure performance under these contracts.

## RELATED PARTY TRANSACTIONS

Physicians, who control the minority interests in each of their respective Centers, routinely provide independent professional services directly to patients utilizing the facilities of the Centers. Note 11 of the Corporation's consolidated financial statements for the year ended December 31, 2006 contains details of transactions with related parties for the current and prior periods.

## CRITICAL ACCOUNTING ESTIMATES

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

Management estimates are required with respect to the valuation of acquired assets and liabilities, intangible assets, goodwill, accounts receivable, inventories and provisions for potential liabilities, as well as the determination of net revenue and income tax provisions.

Net revenue of the Corporation includes amounts for services billed to federal and state agencies, private insurance carriers, employers, managed care programs, and patients. Billed revenues are recorded net of the estimated contractual adjustments provided for under the various agreements with the majority of these third party payors. Management establishes the contractual allowance adjustments and allowances for doubtful accounts based on third party contracts in effect and based on historical payment data, current economic conditions, and other pertinent factors for each Center.

## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING AND DISCLOSURE CONTROLS

### Management Responsibility

Management is responsible for the financial information published by the Corporation. In accordance with Multilateral Instrument 52-109, the CEO and CFO have certified that annual filings fairly present the financial condition, results of operations and cash flows and have also certified regarding controls as described below. By their nature, controls, no matter how well conceived or operated, provide reasonable assurance, but not absolute assurance, that the objectives of the control systems will be met.

### Internal controls over financial reporting ("ICOFR")

The Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") of the Corporation have designed internal controls over financial reporting or have caused them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

During the design process, possible control weaknesses were identified such that a material misstatement or fraud might not be prevented. Due to the limited number of staff at the corporate office, it is not possible to achieve complete segregation of duties and maintain adequate user access controls. In addition, the finance personnel do not have all the technical knowledge to address complex and non-routine accounting issues, including the identification of differences between US and Canadian GAAP (as Centers maintain their accounts under US GAAP and the Corporation reports under Canadian GAAP) and the calculation of and accounting for income taxes.

At this time, management has no intention or plan to alter the existing corporate office structure. However, certain monitoring and oversight controls are in place and, on a regular basis, the Corporation consults with, and utilizes the services of, third party expert advisors.

### Disclosure controls

Under the supervision of and with the participation of the CEO and the CFO, management performed an evaluation of the design and effectiveness of the disclosure controls and procedures that provide reasonable assurance that material information relating to the Corporation (including its subsidiaries) is made known to the CEO and CFO by others within the Corporation. Based on that evaluation, the CEO and the CFO have concluded that the design and operation of these disclosure controls and procedures as of December 31, 2006 were effective.

### Restatement

In the third quarter of 2006, the Corporation restated its consolidated financial statements for the years ended December 31, 2005 and December 31, 2004, as well as its interim consolidated financial statements for the quarters ended March 31, 2006 and June 30, 2006 to correct the method of accounting for foreign exchange forward contracts. The restated consolidated financial statements are available on SEDAR at www.sedar.com.

## RISK FACTORS

### Risks Related to the Business and the Industry of the Corporation.

The revenue and profitability of the Corporation and its subsidiaries, including the Centers, depend heavily on payments from third-party payors, including government healthcare programs (Medicare and Medicaid) and managed care organizations, which are subject to frequent cost containment initiatives. Changes in the terms and conditions of, or reimbursement levels under, insurance or healthcare programs, which are typically short-term agreements, could adversely affect the revenue and profitability of the Corporation. The Corporation's revenues and profitability could be impacted by its ability to obtain and

maintain contractual arrangements with insurers and payors active in its service area and by changes in the terms of such contractual arrangements.

The revenue and profitability of the Centers is dependent upon physician relationships. There can be no assurance that physician groups performing procedures at the Centers will maintain successful medical practices, or that one or more key members of a particular physician group will continue practicing with that group or that the members of that group will continue to perform procedures at the Centers at current levels, or at all.

Healthcare facilities, such as the Centers, are subject to numerous legal, regulatory, professional and private licensing, certification and accreditation requirements. Receipt and renewal of such licenses, certifications and accreditations are often based on inspections, surveys, audits, investigations or other reviews, some of which may require affirmative compliance actions by the Centers that could be burdensome and expensive.

There are a number of United States federal and state regulatory initiatives, which apply to healthcare providers, and in particular specialty hospitals, including the Centers. Among the most significant are the federal Anti-Kickback Statute, the federal Stark Act, and the federal rules relating to management and protection of patient records and patient confidentiality. New legislation or amendments to existing legislation could be enacted in the future, which could materially impact the operations and/or economic viability of surgical hospitals, including the Centers.

While the Centers carry general and professional liability insurance against claims arising in the ordinary course of business, the insurance market is dynamic and there can be no assurance that adequate coverage will be available in the future, nor that any coverage in place will be adequate to cover claims.

Any expansion of the Centers will require additional capital, which may be funded through additional debt or equity financings. These funding sources could result in significant additional interest expense or ownership dilution to current holders of the Corporation's securities. Additionally, the complex regulatory requirements to which the Centers are subject may limit their ability to expand.

There is significant competition in the healthcare business. The Centers compete with other healthcare facilities in providing services to physicians and patients, contracting with managed care payors and recruiting qualified staff.

**Risks Related to the Structure of the Corporation**

The Corporation is solely dependent on the operations and assets of the Centers through the indirect ownership of between 51% and 52.95% of these Centers. Future distributions by the Corporation are not guaranteed and are totally dependent upon the operating results and related cash flows from the Centers.

The payout by the Centers and the Corporation of a substantial majority of their operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future.

The Corporation's distributions to its security holders are denominated in Canadian dollars whereas all of its revenue is denominated in US dollars. To the extent that future distributions are not covered by foreign currency exchange contracts, the Corporation is exposed to currency exchange rate risk.

Interest on the Corporation's subordinated notes will be deducted for purposes of calculating taxes payable in the United States by the Corporation. There can be no assurance that US tax authorities will not seek to challenge the treatment of these notes as debt or the amount of interest expense deducted. This would reduce the Corporation's after-tax income available for distribution, thereby reducing the Corporation's ability to declare dividends.

There can be no assurance that the Corporation will be able to repay the principal amount outstanding on its subordinated notes payable when due. Additionally, the subordinated notes are payable in Canadian dollars. Therefore the Corporation is exposed (at maturity and or repayment) to currency exchange rate risk with respect to the principal amount of this indebtedness.

The limited cash flow guarantees provided by each Center with respect to the interest payments on the subordinated debt may not be enforceable, thereby reducing the cash available for payment of interest on the subordinated debt. Non-competition agreements executed by physician owners of the minority interests in the Centers may not be enforceable, which lack of enforceability could impact the revenues and profitability of the Centers.

The Corporation does not have the ability to direct day-to-day governance or management inputs in respect of the Centers, except in certain circumstances.

The degree to which the Corporation is leveraged on a consolidated basis could have important consequences to the holders of the IPS, including:

(a) The Corporation's and Centers' ability in the future to obtain additional financing for working capital, capital expenditures, acquisitions or other purposes may be limited. Under the terms attaching to the Corporation's subordinated notes payable, the Corporation's ability to incur additional debt, including the issue of IPS, which contain a debt component, is dependent upon the Corporation meeting certain pro forma financial ratios at the time of incurring the additional debt.

(b) The Corporation or Centers being unable to refinance indebtedness on terms acceptable to the Corporation or at all.

(c) A significant portion of the Corporation's cash flow (on a consolidated basis) from operations is likely to be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future operations, capital expenditures, acquisitions and/or dividends on its common shares.

(d) The Centers may be vulnerable to economic downturns and limited in their ability to withstand competitive pressures.

The Corporation has credit facilities that contain restrictive covenants that limit the discretion of the Corporation or its management with respect to certain matters. The ability of the Centers to make distributions will be subject to the restrictive covenants contained in each credit facility.

Additional IPS or common shares may be issued by the Corporation pursuant to an Exchange Agreement with the holders of the minority interests in the Centers or in connection with a future financing or acquisition by the Corporation. The issuance of additional IPSs or Common Shares may dilute an investor's investment in the Corporation and reduce distributable cash per Common Share or per IPS.

The Corporation's subsidiary, which holds the interests in the Centers, is organized under the laws of the State of Delaware. The Centers that are located in South Dakota are formed under the laws of the State of South Dakota and the Center that is located in Oklahoma is formed under the laws of the State of Oklahoma. All of the assets of the Centers are located outside of Canada and certain of the directors and officers are residents of the United States. As a result, it may be difficult or impossible for investors to effect service within Canada upon the Corporation's subsidiary, the Centers, or their directors and officers who are not residents of Canada, or to realize against them in Canada upon judgments of courts of Canada predicated upon the civil liability provisions of applicable Canadian provincial securities laws.

There can be no assurance that the common shares and subordinated notes represented by the IPSs will continue to be qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans.

The market price for the IPS may be subject to general volatility.

On October 31, 2006 the Department of Finance (Canada) announced the "Tax Fairness Plan" whereby the income tax rules applicable to publicly traded trusts and partnerships will be significantly modified. In particular, certain income of (and distributions made by) these entities will be taxed in a manner similar to income earned by (and distributions made by) a corporation. Based on the information currently available, the proposed new rules do not apply to the Corporation or to distributions made by it. However, there can be no assurance that amendments will not be introduced when the legislation is enacted, which may affect the application of the rules to the Corporation.

For further discussion of the foregoing and other risk factors reference should be made to the Corporation's Annual Information Form available on SEDAR at www.sedar.com or on the Corporation's website at www.medicalfacilitiescorp.com.

**OUTLOOK**

Demand for healthcare services in the United States continues to be positively impacted by changing demographics (increasing average age and life expectancy), and advances in science and technology. The Corporation is well positioned to benefit from these trends by providing high quality health care services, enhancing the experience of patients, and offering expanded and new services. Nonetheless, there will continue to be industry-wide pressures on reimbursement programs to limit the escalation in healthcare costs.

Growth in consolidated revenue and operating income during 2006 was due to strong performance at the three centers located in South Dakota, each of which recorded revenue and operating income growth as compared to 2005. In 2006, OSH recorded declines in revenue and operating income as compared to 2005. However, for the 4Q 2006 the rate of decline in revenue and operating income decreased from that of the first three quarters of 2006.

Management believes that continuation of the growth at the South Dakota centers, possibly at more moderate levels and continuation of the positive trend at OSH in 4Q 2006 are representative of the near term outlook and the operating capabilities of the existing Centers.

The Corporation's payout ratio for the most recent twelve months now stands at 85.54%, down from 90.26% for the year ended December 31, 2005. Based on the foreign exchange hedging contracts currently in place, the payout ratio would increase to 91.8%, 95.4%, and 99.1% for each of the years 2007, 2008 and 2009 respectively based on cash available for distribution in U.S. dollars being the same as realized in 2006 and an annual distribution of C$1.10 per IPS. Management believes that the expected revenue and operating income growth, referred to above, will mitigate some or all of the negative impact on the payout ratio over the next three years from exchanging U.S. dollars into Canadian dollars at rates established under the Corporation's hedging program.

The Corporation intends to continue its strategies of enhancing the operating efficiency of the four Centers, pursuing acquisitions and continuing the cash distribution practices referred to in Liquidity, Capital Resources and Financial Condition section of this Management Discussion and Analysis.

News release via Canada NewsWire, Toronto 416-863-9350

Attention Business/Financial Editors:
Medical Facilities Corporation announces March distribution

/NOT FOR DISTRIBUTION TO UNITED STATES NEWSWIRE SERVICES OR FOR DISSEMINATION IN THE UNITED STATES/

TORONTO, March 22 /CNW/ - Medical Facilities Corporation (TSX:DR.UN) (the "Corporation") announced today that a cash payment of Cdn$0.0917 per Income Participating Security will be payable on April 16, 2007 to holders of record of Income Participating Securities at the close of business on March 30, 2007.

Each of the Company's Income Participating Securities is comprised of one common share and Cdn$5.90 aggregate principal amount of 12.5% subordinated notes. The total payment of Cdn$0.0917 reflects a cash dividend of Cdn$0.0302 per common share and an interest payment of Cdn$0.0615 per Cdn$5.90 aggregate principal amount of 12.5% subordinated notes each for the month of March. The ex-dividend date for this distribution will be March 28, 2007. Medical Facilities Corporation designates this dividend to be an "eligible dividend" pursuant to subsection 89(14) of the Income Tax Act (Canada) and its equivalent in any provinces of Canada.

About Medical Facilities Corporation

MFC owns controlling interests in four surgical hospitals, three located in South Dakota and one in Oklahoma. The four hospitals perform scheduled surgical, imaging and diagnostic procedures and derive their revenue from the fees charged for the use of their facilities. The Corporation is structured so that a majority of its free cash flows from operations are distributed to holders of its IPS with a portion of such distributions being interest payments on the subordinated debt component. For more information, please visit www.medicalfacilitiescorp.ca

Caution concerning forward-looking statements

This news release may be interpreted to contain forward-looking statements. Such statements involve known and unknown risks, uncertainties and other factors outside of management's control that could cause actual results to differ materially from those described in the forward-looking statements. The Corporation does not assume responsibility for the accuracy and completeness of those forward-looking statements and does not undertake the obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.

%SEDAR: 00020386E

/For further information: Michael Salter, Chief Financial Officer, Medical Facilities Corp., (416) 848-7980 or 1-877-402-7162; Bruce Wigle, Investor Relations, The Equicom Group Inc., (416) 815-0700 ext. 228 or 1-800-385-5451 ext.228, Email: bwigle(at)equicomgroup.com/
(DR.UN.)

CO: Medical Facilities Corporation

CNW 08:30e 22-MAR-07

File Number 82-34942



MEDICAL FACILITIES CORPORATION



**Form 52-109F1**
**Certification of Annual Filings**

I, **Donald Schellpfeffer,** Chief Executive Officer of Medical Facilities Corporation, certify that:

1. I have reviewed the annual filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of **Medical Facilities Corporation** (the issuer) for the period ending **December 31, 2006**;
2. Based on my knowledge, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the annual filings; and
3. Based on my knowledge, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the annual filings.
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:
   (a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the annual filings are being prepared;
   (b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and
   (c) evaluated the effectiveness of the issuer's disclosure controls and procedures as of the end of the period covered by the annual filings and have caused the issuer to disclose in the annual MD&A our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings based on such evaluation; and
5. I have caused the issuer to disclose in the annual MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Date: March 30, 2007

Donald Schellpfeffer
**Donald Schellpfeffer**
Chief Executive Officer

File Number 82-34942



MEDICAL FACILITIES CORPORATION



**Form 52-109F1**
**Certification of Annual Filings**

I, **Michael Salter,** Chief Financial Officer of Medical Facilities Corporation, certify that:

1. I have reviewed the annual filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) of **Medical Facilities Corporation** (the issuer) for the period ending **December 31, 2006**;
2. Based on my knowledge, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the annual filings; and
3. Based on my knowledge, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the annual filings.
4. The issuer's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the issuer, and we have:
   (a) designed such disclosure controls and procedures, or caused them to be designed under our supervision, to provide reasonable assurance that material information relating to the issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the annual filings are being prepared;
   (b) designed such internal control over financial reporting, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP; and
   (c) evaluated the effectiveness of the issuer's disclosure controls and procedures as of the end of the period covered by the annual filings and have caused the issuer to disclose in the annual MD&A our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by the annual filings based on such evaluation; and
5. I have caused the issuer to disclose in the annual MD&A any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent interim period that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Date: March 30, 2007

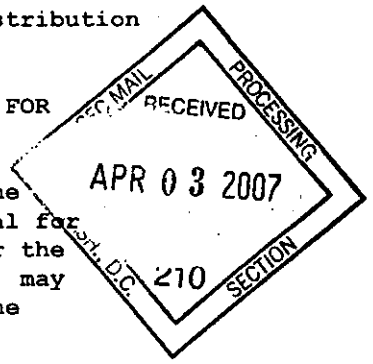
Michael Salter

**Michael Salter**
Chief Financial Officer

News release via Canada NewsWire, Toronto 416-863-9350

Attention Business Editors:
Medical Facilities Corporation announces introduction of Distribution Reinvestment and Unit Purchase Plan

/NOT FOR DISTRIBUTION TO UNITED STATES NEWSWIRE SERVICES OR FOR DISSEMINATION IN THE UNITED STATES/




TORONTO, March 30 /CNW/ - Medical Facilities Corporation (the "Corporation") (TSX:DR.UN), today announced that it has received approval for its Distribution Reinvestment and Unit Purchase Plan (the "Plan"). Under the Plan, Canadian beneficial holders ("unitholders") of IPS units ("units") may elect to re-invest their monthly distributions in additional units of the Corporation. The Corporation will pay commissions, service charges or brokerage fees in connection with the purchase of these units.

The Plan will be available starting with the April 2007 distribution, which is payable on May 15, 2007 to unitholders of record on April 19, 2007. Unitholders wishing to enrol in the Plan should; a) contact their securities broker, bank or trust company and direct them to take all necessary actions to permit their participation in the Plan or, b) deliver the enrolment form, Form A - Certificate of Beneficial Ownership to the Corporation.

The full text of the Plan, a Question and Answer document and enrolment form will be mailed to unitholders of Medical Facilities Corp. along with Annual Meeting materials on April 20, 2007. These documents are also available on the Corporation's website at www.medicalfacilitescorp.ca under the Investor Relations section.

About Medical Facilities Corporation

MFC owns controlling interests in four surgical hospitals, three located in South Dakota and one in Oklahoma. The four hospitals perform scheduled surgical, imaging and diagnostic procedures and derive their revenue from the fees charged for the use of their facilities. The Corporation is structured so that a majority of its free cash flows from operations are distributed to holders of its IPS with a portion of such distributions being interest payments on the subordinated debt component. For more information, please visit www.medicalfacilitiescorp.ca

Caution concerning forward-looking statements

Statements made in this news release, other than those concerning historical financial information, may be forward-looking and therefore subject to various risks and uncertainties. Some forward-looking statements may be identified by words like "may", "will", "anticipate", "estimate", "expect", "intend", or "continue" or the negative thereof or similar variations. Certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from those expressed or implied in such statements. Factors that could cause results to vary include those identified in the Corporation's filings with Canadian securities regulatory authorities such as legislative or regulatory developments, intensifying competition, technological change and general economic conditions. All forward-looking statements presented herein should be considered in conjunction with such filings. The Corporation does not undertake to update any forward-looking statements; such statements speak only as of the date made.

%SEDAR: 00020386E

/For further information: Michael Salter, Chief Financial Officer, Medical Facilities Corp., (416) 848-7980 or 1-877-402-7162; Bruce Wigle, Investor Relations, The Equicom Group Inc., (416) 815-0700 ext. 228 or 1-800-385-5451 ext. 228, Email: bwigle(at)equicomgroup.com/
(DR.UN.)

CO: Medical Facilities Corporation

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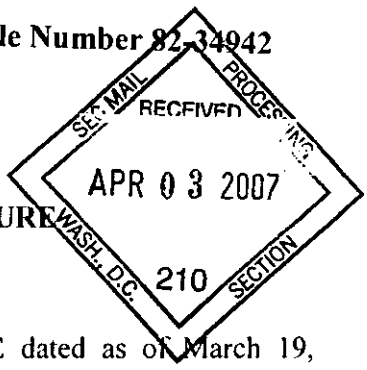





# SECOND SUPPLEMENTAL NOTE INDENTURE

**SECOND SUPPLEMENTAL NOTE INDENTURE** dated as of March 19, 2007 (the "**Supplemental Note Indenture**") to the 12.5% Subordinated Note Indenture (the **"Note Indenture"**) dated as of March 29, 2004 (as supplemented by the first supplemental note indenture dated as of June 21, 2005), among **MEDICAL FACILITIES CORPORATION**, a corporation continued under the laws of the Province of British Columbia (the "**Company**"), **MEDICAL FACILITIES HOLDINGS (USA), LLC ("Medical Facilities USA")**, and **COMPUTERSHARE TRUST COMPANY OF CANADA**, as trustee (the "**Trustee**") and not in its personal capacity.

Capitalized terms used herein and not otherwise defined shall have the meaning set out in the Note Indenture.

**WHEREAS** section 9.02(a)(ii) of the Note Indenture provides that the Company, Medical Facilities USA and the Trustee may amend the Note Indenture provided that the Company has obtained the approval of a majority of the principal amount of the Subordinated Notes of the Company (the "Securities") represented at a meeting of holders of Securities (the "Securityholders") held in accordance with Article 10 of the Note Indenture;

**AND WHEREAS** section 10.11(c) of the Note Indenture provides that the Securityholders, pursuant to an Extraordinary Resolution, have the power to assent to any modification of or change in or addition to or omission form the provisions contained in the Note Indenture, including the entering into of one or more indentures supplemental to the Note Indenture for this purpose;

**AND WHEREAS** the Company has obtained the approval of a majority of the principal amount of the Securities represented at the meeting of the Securityholders held on May 12, 2006 to amend the Note Indenture as set out below;

**AND WHEREAS** all necessary corporate proceedings of the Company have been duly passed and other proceedings taken and conditions complied with to effect the amendments set out below, to create this Supplemental Note Indenture and to make the execution thereof legal and valid and in accordance with the laws relating to the Company and with all other laws and regulations in respect thereof;

**NOW THEREFORE**, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, each party agrees as follows:

1. This Supplemental Note Indenture is entered into pursuant to Section 9.02(a) of the Note Indenture.

2. Section 2.21 of the Note Indenture is deleted.

3. The following two paragraphs are added to the end of section 4.03(c) of the Note Indenture:

(xii) Indebtedness which is Incurred to provide all or a portion of the funds or credit support used to consummate an acquisition by the Company or any of its Subsidiaries (whether such acquisition is to be effected by way of a share purchase, asset purchase, merger or other means) provided, however, that after giving effect to such acquisition and the Incurrence of such Indebtedness:

(A) the Debt Service Coverage Ratio would be greater than immediately prior to such acquisition and the Incurrence of such Indebtedness;

(B) the Consolidated Net Debt to Consolidated EBITDA Ratio for the most recently ended four full fiscal quarters of the Company for which internal financial statements are available immediately preceding the date upon which such additional Indebtedness is Incurred would have been less than:

(i) 5.75 to 1.0 if the incurrence of issuance occurs on or before March 29, 2009; and

(ii) 5.5 to 1.0 if the incurrence or issuance occurs on or after March 29, 2009,

in the case of both (A) and (B) determined on a *pro rata* basis (including a *pro forma* application of the net proceeds therefrom), as if the additional Indebtedness had been Incurred and the application of proceeds therefrom had occurred at the beginning of such four-quarter period; and

(xiii) the Incurrence by the Company or any of its Subsidiaries of Indebtedness represented by purchase money obligations, or other Indebtedness in each case incurred for the purpose of financing all or any part of the purchase price of the Company (and/or assets related thereto), in an aggregate principal amount, including all Refinancing Indebtedness incurred to refund, refinance or replace any Indebtedness incurred pursuant to this paragraph (xiii), not to exceed any time outstanding $30 million, provided that no Incurrence(s) under this paragraph relating to the acquisition of any Person (and/or assets related thereto) shall exceed $15 million in the aggregate.

4. The definition of "Exchangeable Interests" is expanded to include any parallel interests granted in connection with the acquisition of additional facilities.

5. The Company shall indemnify the Trustee against all or any loss, liability, claim, damage or expense incurred or suffered by the Trustee for any act or acts arising from the execution of the Supplemental Note Indenture.

The signature of any of the parties hereto may be evidenced by a facsimile copy of this document bearing such signature and this Supplemental Note Indenture may be signed in one or more counterparts, each of which so signed shall be deemed to be an original, and such counterparts together shall constitute one and the same instrument and, notwithstanding the date of execution of any counterpart, each counterpart shall be deemed to bear the effective date first written above.

[Remainder of page intentionally left blank]

**IN WITNESS WHEREOF**, the parties have caused this Supplemental Note Indenture to be duly executed as of the date first written above.

**MEDICAL FACILITIES CORPORATION**

By: *"Michael Salter"*
Michael Salter
Chief Financial Officer

**COMPUTERSHARE TRUST COMPANY OF CANADA, as Trustee**

Per: *"Mircho Mirchev"*
Name: Mircho Mirchev
Title: Administrator, Corporate Trust

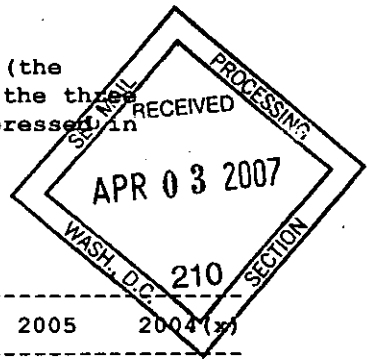
Per: *"Ann Samuel"*
Name: Ann Samuel
Title: Administrator, Corporate Trust

**MEDICAL FACILITIES HOLDINGS (USA), LLC**

Per: *"Michael Salter"*
Michael Salter
Chief Financial Officer

News release via Canada NewsWire, Toronto 416-863-9350

Attention Business/Financial Editors:
Medical Facilities Corporation Reports Fiscal 2006 Year End Financial Results




TORONTO, March 23 /CNW/ - Medical Facilities Corporation (the "Corporation") (TSX:DR.UN), today reported its financial results for the three and twelve-month periods ended December 31, 2006. All amounts are expressed in U.S. dollars unless indicated otherwise.

HIGHLIGHTS

<<

| ($millions) | 2006 | 2005 | 2004(x) |
|---|---|---|---|
| Net revenues | U$148.5 | U$122.0 | U$72.0 |
| Operating income | U$60.1 | U$50.6 | U$33.1 |
| Cash available for distribution(1) per IPS | C$1.286 | C$1.233 | C$0.911 |
| Distributions declared per IPS | C$1.100 | C$1.113 | C$0.834 |
| Payout ratio | 85.5% | 90.3% | 91.6% |

(x) Results for 2004 are for the period from March 29, 2004 to December 31, 2004.

>>

"Our year-over-year net revenue and operating income growth of 21.8% and 18.8% respectively was driven by solid performance at our South Dakota centres. While our Oklahoma hospital recorded year over year declines in net revenue and operating income during the year, its overall results for the year made a positive contribution," said Dr. Donald Schellpfeffer, CEO of Medical Facilities Corp. "Looking ahead, we believe we can build on our positive momentum as we continue to focus on delivering exceptional patient care and an enhanced patient experience, combined with our commitment to increasing our physicians' productivity and providing competitive rates for our payors."

"We remain committed to capitalizing on strategic opportunities, including accretive acquisitions of additional specialty hospitals, ambulatory surgery centers or medical imaging clinics to build value for our stakeholders and strengthen our profile within the growing US healthcare services market."

Financial Results

For the three months ended December 31, 2006, the Corporation generated cash available for distribution(1) ("CAFD") of C$10.0 million or C$0.357 per IPS unit, and declared distributions (comprised of interest on subordinated notes and dividends on common shares) of C$7.7 million or C$0.275 per IPS unit, resulting in a payout ratio of 77.0% for the quarter. For the twelve months ended December 31, 2006, the Corporation generated CAFD of C$36.0 million or C$1.286 per IPS unit, and declared distributions (comprised of interest on subordinated notes and dividends on common shares) of C$30.8 million or C$1.100 per IPS unit, representing a payout ratio of 85.5%. Significant portions of the Corporation's expected future U.S. dollar cash flows available for distribution are hedged and will be converted at exchange rates averaging C$1.275, C$1.182, and C$1.110 in each of the next three years.

Net patient service revenues ("net revenues") for the fourth quarter of 2006 increased 13.3% to $42.0 million compared to $37.1 million in the fourth quarter of 2005. Net revenues at the three centres in South Dakota (Black Hills, Dakota Plains, Sioux Falls or "South Dakota centres") increased 19.9% in the quarter but were offset by a 1.6% decline in net revenues at the Oklahoma Spine Hospital ("OSH"). Decreased net revenues at OSH resulted from a

decrease in the number of pain management procedures performed, continued changes in reimbursement rates from a payor, and a less favourable payor mix, offset by a 6.4% increase in the number of surgical cases performed over the fourth quarter of 2005.

Consolidated expenses, including salaries and benefits, drugs and supplies and general and administrative costs ("consolidated expenses") for the fourth quarter of 2006 totalled $24.7 million or 58.7% of net revenues compared to $22.3 million or 60.2% of net revenues the fourth quarter a year ago.

Operating income (before depreciation and amortization, interest expense, loss on foreign currency translation and minority interest) in the fourth quarter of 2006 increased by 17.6% to $17.3 million or 41.2% of net revenues, compared to $14.7 million or 39.6% of net revenues in the same quarter a year ago. The increase in operating income reflects improved performance at the South Dakota centres, offset by slightly decreased profitability at OSH.

Net income for the fourth quarter of 2006 totalled $5.4 million or $0.194 per IPS unit (basic and fully diluted), compared to net earnings of $0.5 million or $0.018 per IPS unit (basic and fully diluted) in the fourth quarter of 2005.

For the twelve months ended December 31, 2006, net revenues totalled $148.5 million, operating income totalled $60.3 million or 40.6% of net revenues, and net income totalled $0.02 million or $0.001 per IPS unit (basic and fully diluted). Consolidated expenses for the year ended December 31, 2006 totalled $88.2 million.

As at December 31, 2006, the Corporation had working capital of $38.6 million, including cash and cash equivalents of $15.4 million, compared to working capital of $34.0 million, including cash and cash equivalents of $12.4 million as at December 31, 2005. Long-term debt, including the current portion, was $24.6 million as at December 31, 2006, compared to $24.9 million as at December 31, 2005.

The Corporation's 2006 fourth quarter and year end financial statements and Management's Discussion & Analysis ("MD&A"), for the three and twelve-month periods ended December 31, 2006 will be issued and filed on SEDAR today and will be available via Medical Facilties' web site today at www.medicalfacilitiescorp.ca and the SEDAR web site at www.sedar.com tomorrow.

Notice of Conference Call and Webcast

Management of Medical Facilities will host a conference call today March 23 at 10:00 am (EST) to discuss its 2006 fourth quarter and year end financial results. A live audio webcast of the call will be available at www.medicalfacilitiescorp.ca. Webcast attendees are welcome to listen to the conference in real-time or on-demand at your convenience. A taped replay of the conference call will be available until Friday, March 30 at midnight at 1-877-289-8525 or 416-640-1917, reference number 21219954 followed by the number sign.

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(1) Cash available for distribution is a non-GAAP measure and is not intended to be representative of cash flow or results of operations determined in accordance with GAAP. Accordingly, the Corporation provides a reconciliation of cash available for distributions to reported cash flow from operations. Investors are cautioned that cash available for distribution, as calculated by the Corporation, is unlikely to be comparable to similar measures used by other issuers.

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About Medical Facilities Corporation

MFC owns controlling interests in four surgical hospitals, three located in South Dakota and one in Oklahoma. The four hospitals perform scheduled surgical, imaging and diagnostic procedures and derive their revenue from the fees charged for the use of their facilities. The Corporation is structured so that a majority of its free cash flows from operations are distributed to holders of its IPS with a portion of such distributions being interest

payments on the subordinated debt component. For more information, please visit www.medicalfacilitiescorp.ca

Caution concerning forward-looking statements

Statements made in this news release, other than those concerning historical financial information, may be forward-looking and therefore subject to various risks and uncertainties. Some forward-looking statements may be identified by words like "may", "will", "anticipate", "estimate", "expect", "intend", or "continue" or the negative thereof or similar variations. Certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from those expressed or implied in such statements. Factors that could cause results to vary include those identified in the Corporation's filings with Canadian securities regulatory authorities such as legislative or regulatory developments, intensifying competition, technological change and general economic conditions. All forward-looking statements presented herein should be considered in conjunction with such filings. The Corporation does not undertake to update any forward-looking statements; such statements speak only as of the date made.

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