KINDRED HEALTHCARE, INC
Form 10-Q
November 12, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from_____ to_____ .

Commission file number: 001-14057

KINDRED HEALTHCARE, INC.

(Exact name of registrant as specified in its charter)

Delaware	61-1323993
(State or other jurisdiction of	(I.R.S. Employer

incorporation or organization)	Identification No.)
680 South Fourth Street Louisville, KY	40202-2412
(Address of principal executive offices)	(Zip Code)

(502) 596-7300

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class of Common Stock	Outstanding at October 31, 2013
Common stock, $0.25 par value	54,186,774 shares

KINDRED HEALTHCARE, INC.

FORM 10-Q

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KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenues	$ 1,198,473	$ 1,226,159	$ 3,705,456	$ 3,725,151
Salaries, wages and benefits	733,605	754,761	2,264,525	2,282,803
Supplies	81,812	85,129	251,672	261,586
Rent	79,269	79,312	238,115	234,445
Other operating expenses	269,927	230,076	745,556	699,692
Other (income) expense	52	(3,178)	(983)	(9,479)
Impairment charges	441	406	1,085	1,015
Depreciation and amortization	37,591	41,304	119,872	121,429
Interest expense	25,633	26,663	82,888	79,946
Investment income	(1,235)	(212)	(2,798)	(753)
	1,227,095	1,214,261	3,699,932	3,670,684
Income (loss) from continuing operations before income taxes	(28,622)	11,898	5,524	54,467
Provision (benefit) for income taxes	(9,003)	5,070	4,288	22,926
Income (loss) from continuing operations	(19,619)	6,828	1,236	31,541
Discontinued operations, net of income taxes:				
Income (loss) from operations	(21,609)	3,059	(24,287)	13,777
Loss on divestiture of operations	(65,016)	(2,280)	(77,893)	(3,806)
Income (loss) from discontinued operations	(86,625)	779	(102,180)	9,971
Net income (loss)	(106,244)	7,607	(100,944)	41,512
Earnings attributable to noncontrolling interests	(754)	(41)	(1,252)	(253)
Income (loss) attributable to Kindred	$ (106,998)	$ 7,566	$ (102,196)	$ 41,259
Amounts attributable to Kindred stockholders:				
Income (loss) from continuing operations	$ (20,373)	$ 6,787	$ (16)	$ 31,288
Income (loss) from discontinued operations	(86,625)	779	(102,180)	9,971
Net income (loss)	$ (106,998)	$ 7,566	$ (102,196)	$ 41,259
Earnings (loss) per common share:				
Basic:				
Income (loss) from continuing operations	$ (0.39)	$ 0.13	$	$ 0.59
Discontinued operations:				
Income (loss) from operations	(0.41)	0.05	(0.47)	0.26
Loss on divestiture of operations	(1.24)	(0.04)	(1.49)	(0.07)
Income (loss) from discontinued operations	(1.65)	0.01	(1.96)	0.19

Net income (loss)	$ (2.04)	$ 0.14	$ (1.96)	$ 0.78
Diluted:				
Income (loss) from continuing operations	$ (0.39)	$ 0.13	$	$ 0.59
Discontinued operations:				
Income (loss) from operations	(0.41)	0.05	(0.47)	0.26
Loss on divestiture of operations	(1.24)	(0.04)	(1.49)	(0.07)
Income (loss) from discontinued operations	(1.65)	0.01	(1.96)	0.19
Net income (loss)	$ (2.04)	$ 0.14	$ (1.96)	$ 0.78
Shares used in computing earnings (loss) per common share:				
Basic	52,323	51,676	52,218	51,648
Diluted	52,323	51,709	52,218	51,675
Cash dividends declared and paid per common share	$ 0.12	$	$ 0.12	$

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net income (loss)	$ (106,244)	$ 7,607	$ (100,944)	$ 41,512
Other comprehensive income (loss):				
Available-for-sale securities (Note 9):				
Change in unrealized investment gains	416	559	2,044	1,562
Reclassification of gains realized in net income (loss)	(1,026)		(2,135)	(85)
Net change	(610)	559	(91)	1,477
Interest rate swaps (Note 1):				
Change in unrealized gains (losses)	(183)	(25)	1,133	(1,288)
Reclassification of ineffectiveness realized in net income (loss)	(104)		(380)	
Reclassification of losses realized in net income (loss), net of payments	2	5		206
Net change	(285)	(20)	753	(1,082)
Income tax expense (benefit) related to items of other comprehensive income (loss)	286	(186)	(412)	(18)
Other comprehensive income (loss)	(609)	353	250	377
Comprehensive income (loss)	(106,853)	7,960	(100,694)	41,889
Earnings attributable to noncontrolling interests	(754)	(41)	(1,252)	(253)
Comprehensive income (loss) attributable to Kindred	$ (107,607)	$ 7,919	$ (101,946)	$ 41,636

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

(In thousands, except per share amounts)

	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 44,579	$ 50,007
Cash restricted	3,953	5,197
Insurance subsidiary investments	93,686	86,168
Accounts receivable less allowance for loss of $39,847 September 30, 2013 and $23,959 December 31, 2012	929,931	1,038,605
Inventories	26,291	32,021
Deferred tax assets	16,543	12,663
Income taxes	43,309	13,573
Other	40,032	35,532
	1,198,324	1,273,766
Property and equipment	1,862,049	2,226,903
Accumulated depreciation	(997,057)	(1,083,777)
	864,992	1,143,126
Goodwill	976,611	1,041,266
Intangible assets less accumulated amortization of $50,264 September 30, 2013 and $34,854 December 31, 2012	405,771	439,767
Assets held for sale	22,092	4,131
Insurance subsidiary investments	149,916	116,424
Deferred tax assets	6,250	
Other	240,653	219,466
Total assets	$ 3,864,609	$ 4,237,946
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 169,217	$ 210,668
Salaries, wages and other compensation	354,016	389,009
Due to third party payors	52,134	35,420
Professional liability risks	59,439	54,088
Other accrued liabilities	184,781	137,204
Long-term debt due within one year	8,225	8,942
	827,812	835,331
Long-term debt	1,382,385	1,648,706
Professional liability risks	246,482	236,630
Deferred tax liabilities		9,764

Deferred credits and other liabilities	220,202	214,671
Commitments and contingencies (Note 12)		
Equity:		
Stockholders equity:		
Common stock, $0.25 par value; authorized 175,000 shares; issued 54,149 shares September 30, 2013 and 53,280 shares December 31, 2012	13,537	13,320
Capital in excess of par value	1,149,521	1,145,922
Accumulated other comprehensive loss	(1,632)	(1,882)
Retained earnings (deficit)	(10,275)	98,799
	1,151,151	1,256,159
Noncontrolling interests	36,577	36,685
Total equity	1,187,728	1,292,844
Total liabilities and equity	$ 3,864,609	$ 4,237,946

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

(In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Cash flows from operating activities:				
Net income (loss)	$ (106,244)	$ 7,607	$ (100,944)	$ 41,512
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	42,831	50,600	142,745	149,092
Amortization of stock-based compensation costs	1,553	3,132	7,641	8,011
Amortization of deferred financing costs	2,509	2,375	9,529	7,091
Payment of lender fees related to senior debt modifications	(4,589)		(6,189)	
Provision for doubtful accounts	13,152	9,117	34,489	22,654
Deferred income taxes	2,336	(1,235)	(22,985)	(18,140)
Impairment charges	8,995	708	10,077	1,904
Loss on divestiture of discontinued operations	65,016	2,280	77,893	3,806
Other	6,316	786	5,452	2,753
Change in operating assets and liabilities:				
Accounts receivable	45,862	13,175	26,745	(67,913)
Inventories and other assets	3,467	(5,490)	67	(20,897)
Accounts payable	(12,901)	5,281	(31,979)	(7,252)
Income taxes	(27,969)	7,588	(5,269)	39,285
Due to third party payors	25,931	12,627	16,716	1,688
Other accrued liabilities	44,485	32,938	25,229	27,493
Net cash provided by operating activities	110,750	141,489	189,217	191,087
Cash flows from investing activities:				
Routine capital expenditures	(23,152)	(25,939)	(62,952)	(76,804)
Development capital expenditures	(3,235)	(15,177)	(10,709)	(38,175)
Acquisitions, net of cash acquired	(12,173)	(71,440)	(39,106)	(139,308)
Acquisition deposit	(14,675)		(14,675)	
Sale of assets	236,397		248,700	1,110
Purchase of insurance subsidiary investments	(7,765)	(9,692)	(30,360)	(30,890)
Sale of insurance subsidiary investments	9,899	8,063	35,427	30,073
Net change in insurance subsidiary cash and cash equivalents	(1,416)	(685)	(44,294)	(15,171)
Change in other investments	(140)	1,003	218	1,454

Other	79	(25)	(142)	(1,029)
Net cash provided by (used in) investing activities	183,819	(113,892)	82,107	(268,740)
Cash flows from financing activities:				
Proceeds from borrowings under revolving credit	238,900	364,600	1,100,300	1,329,300
Repayment of borrowings under revolving credit	(519,200)	(390,400)	(1,363,600)	(1,244,900)
Repayment of other long-term debt	(92)	(2,665)	(4,818)	(7,976)
Payment of deferred financing costs	(683)	(288)	(1,340)	(601)
Contribution made by noncontrolling interests				200
Distribution made to noncontrolling interests	(118)		(1,628)	(3,521)
Purchase of noncontrolling interests		(715)		(715)
Issuance of common stock	222		429	
Dividends paid	(6,499)		(6,499)	
Other	53		404	
Net cash provided by (used in) financing activities	(287,417)	(29,468)	(276,752)	71,787
Change in cash and cash equivalents	7,152	(1,871)	(5,428)	(5,866)
Cash and cash equivalents at beginning of period	37,427	37,566	50,007	41,561
Cash and cash equivalents at end of period	$ 44,579	$ 35,695	$ 44,579	$ 35,695
Supplemental information:				
Interest payments	$ 7,899	$ 12,856	$ 63,744	$ 60,490
Income tax payments	2,886	472	16,716	10,318

See accompanying notes.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

Business

Kindred Healthcare, Inc. is a healthcare services company that through its subsidiaries operates transitional care (TC) hospitals, inpatient rehabilitation hospitals (IRFs), nursing centers, assisted living facilities, a contract rehabilitation services business and a home health and hospice business across the United States (collectively, the Company or Kindred). At September 30, 2013, the Company s hospital division operated 102 TC hospitals (certified as long-term acute care (LTAC) hospitals under the Medicare program) and five IRFs in 22 states. The Company s nursing center division operated 102 nursing centers and six assisted living facilities in 22 states. The Company s rehabilitation division provided rehabilitation services primarily in hospitals and long-term care settings. The Company s home health and hospice division provided home health, hospice and private duty services from 105 locations in 11 states.

In 2013 and in recent years, the Company has completed several transactions related to the divestiture or planned divestiture of unprofitable hospitals and nursing centers to improve its future operating results. For accounting purposes, the operating results of these businesses and the losses associated with these transactions have been classified as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all periods presented. Assets held for sale at September 30, 2013 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying unaudited condensed consolidated balance sheet. See Notes 2 and 3 for a summary of divestitures and discontinued operations.

Recently issued accounting requirements

In July 2013, the Financial Accounting Standards Board (the FASB) issued authoritative guidance related to financial statement presentation of an unrecognized tax benefit. The main provisions of the guidance state that an entity must present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The guidance is effective for all interim and annual reporting periods beginning after December 15, 2013. Early adoption is permitted for all entities. The adoption of the guidance is not expected to have a material impact on the Company s business, financial position, results of operations or liquidity.

In February 2013, the FASB amended its authoritative guidance issued in December 2011 related to the deferral of the requirement to present reclassification adjustments out of accumulated other comprehensive income in both the statement in which net income is presented and the statement in which other comprehensive income is presented. The amended provisions require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under United States generally accepted accounting principles to be reclassified to net income in its entirety in the same reporting period. For all other amounts, an entity is required to cross-reference to other disclosures that provide

additional details about these amounts. All other requirements of the original June 2011 update were not impacted by the amendment which became effective for all interim and annual reporting periods beginning after December 15, 2012. The adoption of the guidance did not have a material impact on the Company s business, financial position, results of operations or liquidity.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 BASIS OF PRESENTATION (Continued)

Equity

The following table sets forth the changes in equity attributable to noncontrolling interests and equity attributable to Kindred stockholders for the nine months ended September 30, 2013 and 2012 (in thousands):

For the nine months ended September 30, 2013:	Redeemable noncontrolling interests	Amounts attributable to Kindred stockholders	Nonredeemable noncontrolling interests	Total equity
Balance at December 31, 2012	$	$ 1,256,159	$ 36,685	$ 1,292,844
Comprehensive income (loss):				
Net income (loss)		(102,196)	1,252	(100,944)
Other comprehensive income		250		250
		(101,946)	1,252	(100,694)
Issuance of common stock in connection with employee benefit plans		429		429
Shares tendered by employees for statutory tax withholdings upon issuance of common stock		(2,987)		(2,987)
Income tax provision in connection with the issuance of common stock under employee benefit plans		(1,646)		(1,646)
Stock-based compensation amortization		7,641		7,641
Distribution made to noncontrolling interests			(1,628)	(1,628)
Purchase of noncontrolling interests			268	268
Dividends paid		(6,499)		(6,499)
Balance at September 30, 2013	$	$ 1,151,151	$ 36,577	$ 1,187,728
For the nine months ended September 30, 2012:				
Balance at December 31, 2011	$ 9,704	$ 1,288,921	$ 31,620	$ 1,320,541
Comprehensive income:				
Net income	140	41,259	113	41,372
Other comprehensive income		377		377
	140	41,636	113	41,749
Shares tendered by employees for statutory tax withholdings upon issuance of common stock		(1,856)		(1,856)
		(2,453)		(2,453)

Income tax provision in connection with the issuance of common stock under employee benefit plans				
Stock-based compensation amortization		8,011		8,011
Contribution made by noncontrolling interests			200	200
Distribution made to noncontrolling interests	(571)		(2,950)	(2,950)
Purchase of noncontrolling interests	(2,031)	1,316		1,316
Reclassification of noncontrolling interests	(7,242)		7,242	7,242
Balance at September 30, 2012	$	$ 1,335,575	$ 36,225	$ 1,371,800

The purchase of redeemable noncontrolling interests for the nine months ended September 30, 2012 resulted from a cash payment of $0.7 million and a gain of $1.3 million that was recorded as an increase to equity.

The reclassification between noncontrolling interests for the nine months ended September 30, 2012 resulted from minority ownership interests containing put rights in connection with the RehabCare Merger (as defined) that expired.

Income taxes

The Company s effective income tax rate was 31.5% and 42.6% for the third quarter of 2013 and 2012, respectively, and 77.6% and 42.1% for the nine months ended September 30, 2013 and 2012, respectively. The change in the effective income tax rate for both periods was primarily related to a non-deductible litigation charge that increased the provision for income taxes by approximately $3 million for both periods.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 BASIS OF PRESENTATION (Continued)

Derivative financial instruments

In December 2011, the Company entered into two interest rate swap agreements to hedge its floating interest rate on an aggregate of $225 million of debt outstanding under its $785.5 million senior secured term loan facility (the Term Loan Facility) entered into in June 2011. The interest rate swaps have an effective date of January 9, 2012, and expire on January 11, 2016. The Company is required to make payments based upon a fixed interest rate of 1.8925% calculated on the notional amount of $225 million. In exchange, the Company will receive interest on $225 million at a variable interest rate that is based upon the three-month London Interbank Offered Rate (LIBOR), subject to a minimum rate of 1.5%. The Company determined the interest rate swaps continue to qualify for cash flow hedge accounting treatment at September 30, 2013. However, a Term Loan Facility amendment completed in May 2013 reduced the LIBOR floor from 1.5% to 1.0%, therefore some partial ineffectiveness will result through the expiration of the interest rate swap agreement. For the three and nine months ended September 30, 2013, there was $0.1 million and $0.4 million, respectively, of ineffectiveness recognized related to the interest rate swaps recorded in interest expense. The fair value of the interest rate swaps recorded in other accrued liabilities was $1.5 million and $2.6 million at September 30, 2013 and December 31, 2012, respectively. See Note 11.

Other information

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q of Regulation S-X and do not include all of the disclosures normally required by generally accepted accounting principles or those normally required in annual reports on Form 10-K. Accordingly, these financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2012 filed with the Securities and Exchange Commission (the SEC) on Form 10-K. The accompanying condensed consolidated balance sheet at December 31, 2012 was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the Company s customary accounting practices. Management believes that financial information included herein reflects all adjustments necessary for a fair statement of interim results and, except as otherwise disclosed, all such adjustments are of a normal and recurring nature.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles and include amounts based upon the estimates and judgments of management. Actual amounts may differ from those estimates.

Reclassifications

Certain prior period amounts have been reclassified to conform with the current period presentation.

NOTE 2 DIVESTITURES

During the third quarter of 2013, the Company completed the sale of 16 non-strategic facilities (the Vibra Facilities) for $187 million to an affiliate of Vibra Healthcare, LLC (Vibra). The net proceeds of $180 million from this transaction were used to reduce the Company s borrowings under its $750 million senior secured asset-based revolving credit facility (the ABL Facility).

The Vibra Facilities consist of 14 TC hospitals containing 1,002 licensed beds, one IRF containing 44 licensed beds and one nursing center containing 135 licensed beds. Six of the TC hospitals and the one nursing center were owned facilities. The remaining Vibra Facilities were leased. The Vibra Facilities generated revenues of approximately $272 million and segment operating income of approximately $40 million (excluding the allocation of approximately $8 million of overhead costs) for the year ended December 31, 2012. The Vibra Facilities had aggregate rent expense of approximately $12 million for the year ended December 31, 2012.

The Company recorded a loss on divestiture of $76 million ($63 million net of income taxes) and $94 million ($74 million net of income taxes) during the third quarter of 2013 and for the nine months ended September 30, 2013, respectively, related to the Vibra Facilities. The loss on divestiture included a $68.7 million write-off of goodwill, which was allocated based upon the relative fair value of the Vibra Facilities, and a $21.0 million write-off of intangible assets.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 2 DIVESTITURES (Continued)

On July 31, 2013, the Company completed the sale of seven non-strategic nursing centers (the Signature Facilities) for $47 million to affiliates of Signature Healthcare, LLC (Signature). The proceeds from this transaction were used to reduce the Company s borrowings under its ABL Facility.

The Signature Facilities contain 900 licensed beds. Five of the Signature Facilities were owned facilities and the remaining Signature Facilities were leased. The Signature Facilities generated revenues of approximately $63 million and segment operating income of approximately $11 million (excluding the allocation of approximately $2 million of overhead costs) for the year ended December 31, 2012. The Signature Facilities had aggregate rent expense of approximately $2 million for the year ended December 31, 2012.

The Company recorded a loss on divestiture of $2 million ($1 million net of income taxes) during the third quarter of 2013 related to the Signature Facilities.

The results of operations and losses on divestiture of operations, net of income taxes, for the Signature Facilities and the Vibra Facilities were reclassified to discontinued operations in the third quarter of 2013.

On April 27, 2012, the Company announced that it would not renew seven renewal bundles containing 54 nursing centers (the 2012 Expiring Facilities) under operating leases with Ventas, Inc. (Ventas) that expired on April 30, 2013. The 2012 Expiring Facilities contained 6,140 licensed nursing center beds and generated revenues of approximately $475 million for the year ended December 31, 2012. The annual rent for these facilities approximated $57 million. The Company transferred the operations of all of the 2012 Expiring Facilities to new operators during the nine months ended September 30, 2013. The Company reclassified the results of operations and losses associated with the 2012 Expiring Facilities to discontinued operations, net of income taxes, for all periods presented. The Company received cash proceeds of $13.5 million for the nine months ended September 30, 2013 for the sale of property and equipment and inventory related to the 2012 Expiring Facilities.

NOTE 3 DISCONTINUED OPERATIONS

In accordance with the authoritative guidance for the impairment or disposal of long-lived assets, the divestitures or planned divestiture of unprofitable businesses discussed in Notes 1 and 2 have been accounted for as discontinued operations. Accordingly, the results of operations of these businesses for all periods presented and the losses associated with these transactions have been classified as discontinued operations, net of income taxes, in the accompanying unaudited condensed consolidated statement of operations. At September 30, 2013, the Company held for sale one hospital and 59 nursing centers reported as discontinued operations.

On September 30, 2013, the Company entered into agreements to renew early its leases with Ventas for 22 TC hospitals and 26 nursing centers (collectively, the Renewal Facilities) and exit 59 nursing centers and close another facility (collectively, the 2013 Expiring Facilities). The current lease term for the Renewal Facilities and the 2013 Expiring Facilities was scheduled to expire in April 2015. See Note 10. Under the terms of the agreements, the lease

term for the 2013 Expiring Facilities will expire on September 30, 2014. For accounting purposes, 59 of the 2013 Expiring Facilities qualified as assets held for sale and the Company reflected the operating results as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all historical periods and will reflect the facility scheduled for closure as a discontinued operation upon completion of the exit process. Under the terms of the agreements, the Company will pay $20 million to Ventas in exchange for the early termination of certain leases. The disposal group was measured at its fair value less cost to sell and the Company recorded an asset impairment charge of $7.9 million related to leasehold improvements in the 2013 Expiring Facilities. These charges were recorded in discontinued operations in the third quarter of 2013 in the accompanying unaudited condensed consolidated statement of operations.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 3 DISCONTINUED OPERATIONS (Continued)

A summary of discontinued operations follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenues	$ 171,190	$ 328,247	$ 732,757	$ 1,003,994
Salaries, wages and benefits	80,997	158,157	356,612	482,231
Supplies	12,398	21,466	49,834	64,545
Rent	36,897	32,705	89,091	98,204
Other operating expenses	62,685	101,315	245,209	307,962
Other (income) expense	(11)	24	144	33
Impairment charges	8,554	302	8,992	889
Depreciation	5,240	9,296	22,873	27,663
Interest expense	2	6	10	17
Investment income	(2)	(18)	(29)	(43)
	206,760	323,253	772,736	981,501
Income (loss) from operations before income taxes	(35,570)	4,994	(39,979)	22,493
Provision (benefit) for income taxes	(13,961)	1,935	(15,692)	8,716
Income (loss) from operations	(21,609)	3,059	(24,287)	13,777
Loss on divestiture of operations	(65,016)	(2,280)	(77,893)	(3,806)
Income (loss) from discontinued operations	$ (86,625)	$ 779	$ (102,180)	$ 9,971

The following table sets forth certain discontinued operating data by business segment (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenues:				
Hospital division	$ 42,998	$ 64,634	$ 181,287	$ 203,982
Nursing center division	128,192	263,613	551,470	800,012
	$ 171,190	$ 328,247	$ 732,757	$ 1,003,994
Operating income:				
Hospital division	$ 4,344	$ 6,566	$ 26,514	$ 25,164
Nursing center division	2,223	40,417	45,452	123,170

	$ 6,567	$ 46,983	$ 71,966	$ 148,334
Rent:				
Hospital division	$ 1,797	$ 3,095	$ 6,723	$ 9,371
Nursing center division	35,100	29,610	82,368	88,833
	$ 36,897	$ 32,705	$ 89,091	$ 98,204
Depreciation:				
Hospital division	$ 2,349	$ 3,049	$ 9,327	$ 9,331
Nursing center division	2,891	6,247	13,546	18,332
	$ 5,240	$ 9,296	$ 22,873	$ 27,663

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 3 DISCONTINUED OPERATIONS (Continued)

A summary of the net assets held for sale follows (in thousands):

	September 30, 2013	December 31, 2012
Long-term assets:		
Property and equipment, net	$ 20,738	$ 4,126
Other	1,354	5
	22,092	4,131
Current liabilities (included in other accrued liabilities)	(61)	
	$ 22,031	$ 4,131

NOTE 4 ACQUISITIONS

The following is a summary of the Company s acquisition activities. The operating results of the acquired businesses have been included in the accompanying unaudited condensed consolidated financial statements of the Company from the respective acquisition dates. The purchase price of acquired businesses and acquired leased facilities resulted from negotiations with each of the sellers that were based upon both the historical and expected future cash flows of the respective businesses and real estate values. Each of these acquisitions was financed through operating cash flows and borrowings under the Company s ABL Facility. Unaudited pro forma financial data related to the acquired businesses have not been presented because the acquisitions are not material, either individually or in the aggregate, to the Company s consolidated financial statements.

During the third quarter of 2013, the Company acquired three home health and hospice businesses for $7.2 million and acquired a TC hospital for $5.0 million.

Also, during the nine months ended September 30, 2013, the Company acquired two home health and hospice businesses for $1.7 million and acquired the real estate of a previously leased hospital for $25.2 million. Annual rent associated with the previously leased hospital aggregated $2.5 million.

Acquisition deposits of $14.7 million were made on September 30, 2013, primarily related to the purchase of a hospital rehabilitation services company on October 1, 2013.

During the third quarter of 2012, the Company acquired two home health and hospice businesses for $71.4 million, which included $12.1 million of accounts receivable, $1.1 million of other assets, $1.4 million of property and

equipment, $58.2 million of goodwill, $18.1 million of identifiable intangible assets, $10.4 million of current liabilities, $7.2 million of deferred income tax liabilities and $1.9 million of other long-term liabilities.

During the nine months ended September 30, 2012, the Company acquired the real estate of two previously leased hospitals for $67.9 million. Annual rent associated with the hospitals aggregated $5.5 million.

The fair value of each of the acquisitions noted above was measured using discounted cash flow methodologies which are considered Level 3 inputs (as described in Note 13).

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 5 REVENUES

Revenues are recorded based upon estimated amounts due from patients and third party payors for healthcare services provided, including anticipated settlements under reimbursement agreements with Medicare, Medicaid, Medicare Advantage and other third party payors.

A summary of revenues by payor type follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Medicare	$ 490,312	$ 508,563	$ 1,560,265	$ 1,572,906
Medicaid	153,822	145,358	437,071	433,190
Medicare Advantage	91,453	91,784	284,028	277,277
Other	516,652	533,024	1,588,836	1,602,812
	1,252,239	1,278,729	3,870,200	3,886,185
Eliminations	(53,766)	(52,570)	(164,744)	(161,034)
	$ 1,198,473	$ 1,226,159	$ 3,705,456	$ 3,725,151

NOTE 6 EARNINGS (LOSS) PER SHARE AND DIVIDENDS

Earnings (loss) per common share are based upon the weighted average number of common shares outstanding during the respective periods. The diluted calculation of earnings per common share includes the dilutive effect of stock options. The Company follows the provisions of the authoritative guidance for determining whether instruments granted in share-based payment transactions are participating securities, which requires that unvested restricted stock that entitles the holder to receive nonforfeitable dividends before vesting be included as a participating security in the basic and diluted earnings per common share calculation pursuant to the two-class method.

The Company s Board of Directors approved a quarterly cash dividend to its shareholders of $0.12 per common share that was paid on September 9, 2013 to shareholders of record as of the close of business on August 19, 2013. Future declarations of quarterly dividends will be subject to the approval of Kindred s Board of Directors.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 6 EARNINGS (LOSS) PER SHARE AND DIVIDENDS (Continued)

A computation of earnings (loss) per common share follows (in thousands, except per share amounts):

	Three months ended September 30,				Nine months ended September 30,			
	2013		2012		2013		2012	
	Basic	Diluted	Basic	Diluted	Basic	Diluted	Basic	Diluted
Earnings (loss):								
Amounts attributable to Kindred stockholders:								
Income (loss) from continuing operations:								
As reported in Statement of Operations	$ (20,373)	$ (20,373)	$ 6,787	$ 6,787	$ (16)	$ (16)	$ 31,288	$ 31,288
Allocation to participating unvested restricted stockholders			(173)	(172)			(660)	(659)
Available to common stockholders	$ (20,373)	$ (20,373)	$ 6,614	$ 6,615	$ (16)	$ (16)	$ 30,628	$ 30,629
Discontinued operations, net of income taxes:								
Income (loss) from operations:								
As reported in Statement of Operations	$ (21,609)	$ (21,609)	$ 3,059	$ 3,059	$ (24,287)	$ (24,287)	$ 13,777	$ 13,777
			(78)	(78)			(290)	(290)

Allocation to participating unvested restricted stockholders								
Available to common stockholders	$ (21,609)	$ (21,609)	$ 2,981	$ 2,981	$ (24,287)	$ (24,287)	$ 13,487	$ 13,487
Loss on divestiture of operations:								
As reported in Statement of Operations	$ (65,016)	$ (65,016)	$ (2,280)	$ (2,280)	$ (77,893)	$ (77,893)	$ (3,806)	$ (3,806)
Allocation to participating unvested restricted stockholders			58	58			80	80
Available to common stockholders	$ (65,016)	$ (65,016)	$ (2,222)	$ (2,222)	$ (77,893)	$ (77,893)	$ (3,726)	$ (3,726)
Income (loss) from discontinued operations:								
As reported in Statement of Operations	$ (86,625)	$ (86,625)	$ 779	$ 779	$ (102,180)	$ (102,180)	$ 9,971	$ 9,971
Allocation to participating unvested restricted stockholders			(20)	(20)			(210)	(210)
Available to common stockholders	$ (86,625)	$ (86,625)	$ 759	$ 759	$ (102,180)	$ (102,180)	$ 9,761	$ 9,761
Net income (loss):								
As reported in Statement of Operations	$ (106,998)	$ (106,998)	$ 7,566	$ 7,566	$ (102,196)	$ (102,196)	$ 41,259	$ 41,259
Allocation to participating unvested restricted stockholders			(193)	(192)			(870)	(869)
Available to common stockholders	$ (106,998)	$ (106,998)	$ 7,373	$ 7,374	$ (102,196)	$ (102,196)	$ 40,389	$ 40,390

Shares used in the computation:								
Weighted average shares outstanding basic computation	52,323	52,323	51,676	51,676	52,218	52,218	51,648	51,648
Dilutive effect of employee stock options				33				27
Adjusted weighted average shares outstanding diluted computation		52,323		51,709		52,218		51,675
Earnings (loss) per common share:								
Income (loss) from continuing operations	$ (0.39)	$ (0.39)	$ 0.13	$ 0.13	$	$	$ 0.59	$ 0.59
Discontinued operations:								
Income (loss) from operations	(0.41)	(0.41)	0.05	0.05	(0.47)	(0.47)	0.26	0.26
Loss on divestiture of operations	(1.24)	(1.24)	(0.04)	(0.04)	(1.49)	(1.49)	(0.07)	(0.07)
Income (loss) from discontinued operations	(1.65)	(1.65)	0.01	0.01	(1.96)	(1.96)	0.19	0.19
Net income (loss)	$ (2.04)	$ (2.04)	$ 0.14	$ 0.14	$ (1.96)	$ (1.96)	$ 0.78	$ 0.78
Number of antidilutive stock options excluded from shares used in the diluted earnings (loss) per		1,157		1,710		1,179		1,710

common
share
computation

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 7 BUSINESS SEGMENT DATA

The Company is organized into four operating divisions: the hospital division, the nursing center division, the rehabilitation division and the home health and hospice division. Based upon the authoritative guidance for business segments, the operating divisions represent five reportable operating segments, including (1) hospitals, (2) nursing centers, (3) skilled nursing rehabilitation services, (4) hospital rehabilitation services and (5) home health and hospice services. These reportable operating segments are consistent with information used by the Company s President and Chief Operating Officer to assess performance and allocate resources. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. Prior period segment information has been reclassified to conform with the current period presentation.

For segment purposes, the Company defines operating income as earnings before interest, income taxes, depreciation, amortization and rent. Segment operating income reported for each of the Company s operating segments excludes impairment charges, transaction costs and the allocation of corporate overhead.

On January 1, 2013, the Company transferred the operations of its hospital-based sub-acute unit business from the hospital division to the nursing center division. Historical amounts have been reclassified to conform with the current period presentation.

Segment operating income for the nine months ended September 30, 2013 included one-time bonus costs paid to employees who do not participate in the Company s incentive compensation program of $20.4 million (hospital division $8.0 million, nursing center division $5.0 million, rehabilitation division $6.3 million (skilled nursing rehabilitation services $5.0 million and hospital rehabilitation services $1.3 million), home health and hospice division $0.8 million and corporate $0.3 million).

Segment operating income for the hospital division for the three months ended September 30, 2013 included costs of $5.5 million in connection with the closing of a TC hospital and a litigation charge of $0.7 million.

Segment operating income for the hospital division for the nine months ended September 30, 2012 included severance ($2.5 million) and other miscellaneous costs ($1.1 million) incurred in connection with the closing of a regional office and two TC hospitals, and $5.0 million for employment-related lawsuits.

Segment operating income for the nursing center division for the nine months ended September 30, 2012 included $0.9 million incurred in connection with the cancellation of a sub-acute unit project.

Segment operating income for the rehabilitation division for the three months ended September 30, 2013 included $23.1 million of litigation charges (skilled nursing rehabilitation services) and $0.3 million of severance and retirement costs (hospital rehabilitation services).

Segment operating income for the home health and hospice division for the three months ended September 30, 2013 included $0.6 million of severance and retirement costs and $0.5 million of costs associated with closing a home health location.

Segment operating income for corporate for the three months ended September 30, 2013 included $1.0 million of severance and retirement costs and $0.5 million of fees associated with the modification of certain of the Company s senior debt. See Note 11.

Rent expense for the hospital division included $0.6 million and $1.5 million for the three and nine months ended September 30, 2012, respectively, incurred in connection with the closing of two TC hospitals.

Interest expense for corporate included $0.1 million and $1.5 million for the three and nine months ended September 30, 2013, respectively, related to charges associated with the modification of certain of the Company s senior debt. See Note 11.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 7 BUSINESS SEGMENT DATA (Continued)

The following table sets forth certain data by business segment (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenues:				
Hospital division	$ 608,506	$ 636,463	$ 1,909,629	$ 1,967,683
Nursing center division	277,668	282,223	839,630	846,608
Rehabilitation division:				
Skilled nursing rehabilitation services	243,968	252,201	749,884	758,977
Hospital rehabilitation services	68,296	71,899	212,596	219,670
	312,264	324,100	962,480	978,647
Home health and hospice division	53,801	35,943	158,461	93,247
	1,252,239	1,278,729	3,870,200	3,886,185
Eliminations:				
Skilled nursing rehabilitation services	(29,414)	(27,805)	(89,697)	(85,239)
Hospital rehabilitation services	(23,191)	(23,904)	(71,672)	(73,423)
Nursing centers	(1,161)	(861)	(3,375)	(2,372)
	(53,766)	(52,570)	(164,744)	(161,034)
	$ 1,198,473	$ 1,226,159	$ 3,705,456	$ 3,725,151
Income (loss) from continuing operations:				
Operating income (loss):				
Hospital division	$ 112,290	$ 130,798	$ 393,892	$ 414,222
Nursing center division	30,304	37,865	94,204	105,705
Rehabilitation division:				
Skilled nursing rehabilitation services	(8,571)	16,996	23,810	47,419
Hospital rehabilitation services	18,215	16,977	55,920	50,953
	9,644	33,973	79,730	98,372
Home health and hospice division	1,085	3,645	7,832	8,775
Corporate:				
Overhead	(39,151)	(45,883)	(127,932)	(133,334)
Insurance subsidiary	(482)	(545)	(1,375)	(1,627)
	(39,633)	(46,428)	(129,307)	(134,961)
Impairment charges	(441)	(406)	(1,085)	(1,015)
Transaction costs	(613)	(482)	(1,665)	(1,564)
Operating income	112,636	158,965	443,601	489,534
Rent	(79,269)	(79,312)	(238,115)	(234,445)

Depreciation and amortization	(37,591)	(41,304)	(119,872)	(121,429)
Interest, net	(24,398)	(26,451)	(80,090)	(79,193)
Income (loss) from continuing operations before income taxes	(28,622)	11,898	5,524	54,467
Provision (benefit) for income taxes	(9,003)	5,070	4,288	22,926
	$ (19,619)	$ 6,828	$ 1,236	$ 31,541

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 7 BUSINESS SEGMENT DATA (Continued)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Rent:				
Hospital division	$ 50,929	$ 52,197	$ 153,021	$ 153,790
Nursing center division	25,450	24,300	76,144	72,487
Rehabilitation division:				
Skilled nursing rehabilitation services	1,123	1,356	3,555	4,204
Hospital rehabilitation services	19	2	55	119
	1,142	1,358	3,610	4,323
Home health and hospice division	1,193	805	3,534	2,029
Corporate	555	652	1,806	1,816
	$ 79,269	$ 79,312	$ 238,115	$ 234,445
Depreciation and amortization:				
Hospital division	$ 17,483	$ 20,060	$ 56,202	$ 59,247
Nursing center division	6,830	7,298	21,642	21,123
Rehabilitation division:				
Skilled nursing rehabilitation services	2,461	2,811	8,451	8,223
Hospital rehabilitation services	2,281	2,328	6,931	6,975
	4,742	5,139	15,382	15,198
Home health and hospice division	1,638	1,137	4,779	2,960
Corporate	6,898	7,670	21,867	22,901
	$ 37,591	$ 41,304	$ 119,872	$ 121,429
Capital expenditures, excluding acquisitions (including discontinued operations):				
Hospital division:				
Routine	$ 6,421	$ 9,015	$ 22,285	$ 28,455
Development	3,235	14,334	10,702	35,572
	9,656	23,349	32,987	64,027
Nursing center division:				
Routine	5,584	4,965	15,662	12,611
Development		843	7	2,603
	5,584	5,808	15,669	15,214
Rehabilitation division:				
Skilled nursing rehabilitation services:				
Routine	860	707	1,929	1,602
Development				

	860	707	1,929	1,602
Hospital rehabilitation services:				
Routine	31	125	108	231
Development				
	31	125	108	231
Home health and hospice division:				
Routine	522	160	1,056	429
Development				
	522	160	1,056	429
Corporate:				
Routine:				
Information systems	7,298	10,842	19,023	32,901
Other	2,436	125	2,889	575
	$ 26,387	$ 41,116	$ 73,661	$ 114,979

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 7 BUSINESS SEGMENT DATA (Continued)

	September 30, 2013	December 31, 2012
Assets at end of period:		
Hospital division	$ 1,806,718	$ 2,129,303
Nursing center division	485,353	626,016
Rehabilitation division:		
Skilled nursing rehabilitation services	345,616	336,445
Hospital rehabilitation services	343,561	340,668
	689,177	677,113
Home health and hospice division	216,117	202,156
Corporate	667,244	603,358
	$ 3,864,609	$ 4,237,946
Goodwill:		
Hospital division	$ 677,557	$ 747,065
Rehabilitation division:		
Skilled nursing rehabilitation services		
Hospital rehabilitation services	168,019	168,019
	168,019	168,019
Home health and hospice division	131,035	126,182
	$ 976,611	$ 1,041,266

NOTE 8 INSURANCE RISKS

The Company insures a substantial portion of its professional liability risks and workers compensation risks through its wholly owned limited purpose insurance subsidiary. Provisions for loss for these risks are based upon management s best available information including actuarially determined estimates.

The allowance for professional liability risks includes an estimate of the expected cost to settle reported claims and an amount, based upon past experiences, for losses incurred but not reported. These liabilities are necessarily based upon estimates and, while management believes that the provision for loss is adequate, the ultimate liability may be in excess of, or less than, the amounts recorded. To the extent that expected ultimate claims costs vary from historical

provisions for loss, future earnings will be charged or credited.

The provision for loss for insurance risks, including the cost of coverage maintained with unaffiliated commercial insurance carriers, follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Professional liability:				
Continuing operations	$ 12,476	$ 13,536	$ 45,239	$ 41,655
Discontinued operations	7,387	5,597	21,809	16,801
Workers compensation:				
Continuing operations	$ 7,689	$ 11,286	$ 29,633	$ 33,387
Discontinued operations	1,157	4,292	9,282	12,698

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 8 INSURANCE RISKS (Continued)

A summary of the assets and liabilities related to insurance risks included in the accompanying unaudited condensed consolidated balance sheet follows (in thousands):

	September 30, 2013			December 31, 2012		
	Professional liability	Workers compensation	Total	Professional liability	Workers compensation	Total
Assets:						
Current:						
Insurance subsidiary investments	$ 58,579	$ 35,107	$ 93,686	$ 53,133	$ 33,035	$ 86,168
Reinsurance recoverables	6,981		6,981	5,382		5,382
Other		150	150		150	150
	65,560	35,257	100,817	58,515	33,185	91,700
Non-current:						
Insurance subsidiary investments	69,382	80,534	149,916	46,546	69,878	116,424
Reinsurance and other recoverables	66,950	78,027	144,977	58,025	76,794	134,819
Deposits	4,238	1,489	5,727	3,977	1,574	5,551
Other		39	39		40	40
	140,570	160,089	300,659	108,548	148,286	256,834
	$ 206,130	$ 195,346	$ 401,476	$ 167,063	$ 181,471	$ 348,534
Liabilities:						
Allowance for insurance risks:						
Current	$ 59,439	$ 39,158	$ 98,597	$ 54,088	$ 37,096	$ 91,184
Non-current	246,482	161,551	408,033	236,630	156,265	392,895
	$ 305,921	$ 200,709	$ 506,630	$ 290,718	$ 193,361	$ 484,079

Provisions for loss for professional liability risks retained by the Company s limited purpose insurance subsidiary have been discounted based upon actuarial estimates of claim payment patterns using a discount rate of 1% to 5% depending upon the policy year. The discount rate was 1% for the 2013 and 2012 policy years. The discount rates are based upon the risk free interest rate for the respective year. Amounts equal to the discounted loss provision are funded annually. The Company does not fund the portion of professional liability risks related to estimated claims that have been incurred but not reported. Accordingly, these liabilities are not discounted. If the Company did not discount any of the allowances for professional liability risks, these balances would have approximated $308.7 million at September 30, 2013 and $293.3 million at December 31, 2012.

Provisions for loss for workers compensation risks retained by the Company s limited purpose insurance subsidiary are not discounted and amounts equal to the loss provision are funded annually.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 9 INSURANCE SUBSIDIARY INVESTMENTS

The Company maintains investments, consisting principally of cash and cash equivalents, debt securities, equities and certificates of deposit for the payment of claims and expenses related to professional liability and workers compensation risks. These investments have been categorized as available-for-sale and are reported at fair value.

The cost for equities, amortized cost for debt securities and estimated fair value of the Company s insurance subsidiary investments follows (in thousands):

	September 30, 2013				December 31, 2012			
	Cost	Unrealized gains	Unrealized losses	Fair value	Cost	Unrealized gains	Unrealized losses	Fair value
Cash and cash equivalents (a)	$ 184,456	$	$	$ 184,456	$ 140,162	$	$	$ 140,162
Debt securities:								
Corporate bonds	19,080	46	(11)	19,115	21,352	118	(16)	21,454
Debt securities issued by U.S. government agencies	20,058	47	(10)	20,095	16,624	89		16,713
U.S. Treasury notes	7,096	5	(2)	7,099	6,131	3		6,134
	46,234	98	(23)	46,309	44,107	210	(16)	44,301
Equities by industry:								
Industrials	1,096	317		1,413	2,039	331	(53)	2,317
Consumer	948	454		1,402	2,171	599	(15)	2,755
Financial services	814	236	(27)	1,023	1,419	284	(86)	1,617
Healthcare	660	226		886	1,474	179	(14)	1,639
Technology	619	215		834	1,482	268	(70)	1,680
Other	1,433	516	(25)	1,924	2,554	706	(243)	3,017

	5,570	1,964	(52)	7,482	11,139	2,367	(481)	13,025
Certificates of deposit	5,350	5		5,355	5,101	3		5,104
	$ 241,610	$ 2,067	$ (75)	$ 243,602	$ 200,509	$ 2,580	$ (497)	$ 202,592

(a) Includes $9.5 million and $3.7 million of money market funds at September 30, 2013 and December 31, 2012, respectively.

The Company s investment policy governing insurance subsidiary investments precludes the investment portfolio managers from selling any security at a loss without prior authorization from the Company. The investment managers also limit the exposure to any one issue, issuer or type of investment. The Company intends, and has the ability, to hold insurance subsidiary investments for a long duration without the necessity of selling securities to fund the underwriting needs of its insurance subsidiary. This ability to hold securities allows sufficient time for recovery of temporary declines in the market value of equity securities and the par value of debt securities as of their stated maturity date.

The Company considered the severity and duration of its unrealized losses at September 30, 2013 and recognized a $0.1 million pretax other-than-temporary impairment during the nine months ended September 30, 2013 for various investments held in its insurance subsidiary investment portfolio. The Company considered the severity and duration of its unrealized losses at September 30, 2012 for various investments held in its insurance subsidiary investment portfolio and determined that these unrealized losses were temporary and did not record any impairment losses related to these investments.

As a result of deterioration in professional liability and workers compensation underwriting results of the Company s limited purpose insurance subsidiary in 2012 and 2011, the Company made capital contributions of $14.2 million and $8.6 million during the nine months ended September 30, 2013 and 2012, respectively, to its limited purpose insurance subsidiary. These transactions were completed in accordance with applicable regulations. Neither capital contribution had any impact on earnings.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 10 LEASES

On September 30, 2013, the Company entered into agreements to renew early its leases with Ventas for the Renewal Facilities. The current lease term for the Renewal Facilities was scheduled to expire in April 2015.

The Company will renew the existing leases for three TC hospitals and 15 nursing centers for an additional five year term effective May 1, 2015. The annual rents for these facilities will increase by $4.0 million on October 1, 2014 and are subject to various rent escalators contained within the existing master leases. In addition, the Company will renew the leases for 19 TC hospitals and 11 nursing centers for a term of 10 years and seven months effective October 1, 2014. The annual rents for these facilities will increase by $11.0 million on October 1, 2014 and are subject to annual increases based upon the change in the consumer price index (subject to an annual 4% cap). For accounting purposes, the Company will record the additional rents over the new lease term on a straight-line basis beginning on October 1, 2013, the effective date of the agreements.

The current aggregate annual rent for the Renewal Facilities approximates $79 million. The 22 TC hospitals contain 1,753 licensed beds and generated revenues and segment operating income (excluding the allocation of approximately $17 million of overhead costs) of approximately $572 million and $115 million, respectively, for the year ended December 31, 2012. The 26 nursing centers contain 3,134 licensed beds and generated revenues and segment operating income (excluding the allocation of approximately $8 million of overhead costs) of approximately $271 million and $56 million, respectively, for the year ended December 31, 2012. The terms of the new leases are substantially similar to the terms of the existing master lease agreements between the Company and Ventas.

The agreements with Ventas also provided for the Company s exit from 59 nursing centers and the closure of another facility. Under the terms of the agreements, the lease term for the 2013 Expiring Facilities will expire on September 30, 2014. For accounting purposes, 59 of the 2013 Expiring Facilities qualified as assets held for sale and the Company reflected the operating results as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all historical periods and will reflect the facility scheduled for closure as a discontinued operation upon completion of the exit process. See Note 3.

Under the terms of the agreements, the Company will pay $20 million to Ventas in exchange for the early termination of certain leases. The disposal group was measured at its fair value less cost to sell and the Company recorded an asset impairment charge of $7.9 million related to leasehold improvements in the 2013 Expiring Facilities. These charges were recorded in discontinued operations in the third quarter of 2013 in the accompanying unaudited condensed consolidated statement of operations.

NOTE 11 LONG-TERM DEBT

In August 2013, the Company completed amendments and restatements to its ABL Facility and its Term Loan Facility (collectively, the Credit Facilities) to increase its borrowing capacity and improve its financial flexibility. The amendments include, among other things, the following changes: (a) refreshing the option to increase the credit capacity in the aggregate between the Credit Facilities by $250 million; (b) establishing the option to further increase

the credit capacity between the Credit Facilities upon satisfaction of a secured leverage ratio; (c) extending the maturity of the ABL Facility by two years to June 2018; (d) eliminating the annual and cumulative limitations on acquisitions; (e) raising to $150 million the Company s ability to pay cash dividends, buy back stock and make other restricted payments; and (f) easing the restrictions on the Company s ability to make investments and enter into other joint venture arrangements. The interest rate pricing levels were not changed in connection with the amendments.

In May 2013, the Company completed an amendment and restatement of its Term Loan Facility to reduce its annual interest cost by 100 basis points. The applicable interest rate on the Term Loan Facility, which matures on June 1, 2018, was reduced by 50 basis points to LIBOR plus 325 basis points (previously LIBOR plus 375 basis points). In addition, the LIBOR floor was reduced to 1.00% from 1.50%.

The Company recorded fees associated with the amendments of $0.5 million during the three months ended September 30, 2013, which are included in other operating expenses in the accompanying unaudited condensed consolidated statement of operations. The Company also recorded charges associated with the amendments and restatements of $0.1 million and $1.5 million during the three and nine months ended September 30, 2013, respectively, which are included in interest expense in the accompanying unaudited condensed consolidated statement of operations.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 12 CONTINGENCIES

Management continually evaluates contingencies based upon the best available information. In addition, allowances for losses are provided currently for disputed items that have continuing significance, such as certain third party reimbursements and deductions that continue to be claimed in current cost reports and tax returns.

Management believes that allowances for losses have been provided to the extent necessary and that its assessment of contingencies is reasonable.

Principal contingencies are described below:

Revenues Certain third party payments are subject to examination by agencies administering the various reimbursement programs. The Company is contesting certain issues raised in audits of prior year cost reports.

Professional liability risks The Company has provided for losses for professional liability risks based upon management s best available information including actuarially determined estimates. Ultimate claims costs may differ from the provisions for loss. See Note 8.

Income taxes The Company is subject to various federal and state income tax audits in the ordinary course of business. Such audits could result in increased tax payments, interest and penalties.

Legal and regulatory proceedings The Company is a party to various legal actions (some of which are not insured), and regulatory and other governmental and internal audits and investigations in the ordinary course of business (including investigations resulting from the Company s obligation to self-report suspected violations of law by the Company). The Company cannot predict the ultimate outcome of pending litigation and regulatory and other governmental and internal audits and investigations. These matters could potentially subject the Company to sanctions, damages, recoupments, fines and other penalties. The U.S. Department of Justice (the DOJ), the Centers for Medicare and Medicaid Services (CMS) or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company s businesses in the future which may, either individually or in the aggregate, have a material adverse effect on the Company s business, financial position, results of operations and liquidity. See Note 15.

Other indemnifications In the ordinary course of business, the Company enters into contracts containing standard indemnification provisions and indemnifications specific to a transaction, such as a disposal of an operating facility. These indemnifications may cover claims related to employment-related matters, governmental regulations, environmental issues and tax matters, as well as patient, third party payor, supplier and contractual relationships. Obligations under these indemnities generally are initiated by a breach of the terms of a contract or by a third party claim or event.

NOTE 13 FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

The Company follows the provisions of the authoritative guidance for fair value measurements, which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure

purposes under generally accepted accounting principles.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The guidance related to fair value measures establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1	Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain U.S. Treasury, other U.S. Government and agency asset backed debt securities that are highly liquid and are actively traded in over-the-counter markets.
Level 2	Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 13 FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (Continued)

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The Company s assets and liabilities measured at fair value on a recurring and non-recurring basis and any associated losses are summarized below (in thousands):

	Fair value measurements			Assets/liabilities at fair value	Total losses
	Level 1	Level 2	Level 3		
September 30, 2013:					
Recurring:					
Assets:					
Available-for-sale debt securities:					
Corporate bonds	$	$ 19,115	$	$ 19,115	$
Debt securities issued by U.S. government agencies		20,095		20,095	
U.S. Treasury notes	7,099			7,099	
	7,099	39,210		46,309	
Available-for-sale equity securities	7,482			7,482	
Money market funds	13,039			13,039	
Certificates of deposit		5,355		5,355	
Total available-for-sale investments	27,620	44,565		72,185	
Deposits held in money market funds	944	4,238		5,182	
	$ 28,564	$ 48,803	$	$ 77,367	$
Liabilities:					
Interest rate swaps	$	$ (1,516)	$	$ (1,516)	$
Non-recurring:					
Assets:					
Hospitals available for sale	$	$	$ 4,828	$ 4,828	$ (3,164)
Property and equipment			2,820	2,820	(10,077)
	$	$	$ 7,648	$ 7,648	$ (13,241)
Liabilities	$	$	$	$	$

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 13 FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (Continued)

	Fair value measurements				
	Level 1	Level 2	Level 3	Assets/liabilities at fair value	Total losses
December 31, 2012:					
Recurring:					
Assets:					
Available-for-sale debt securities:					
Corporate bonds	$	$ 21,454	$	$ 21,454	$
Debt securities issued by U.S. government agencies		16,713		16,713	
U.S. Treasury notes	6,134			6,134	
	6,134	38,167		44,301	
Available-for-sale equity securities	13,025			13,025	
Money market funds	7,438			7,438	
Certificates of deposit		5,104		5,104	
Total available-for-sale investments	26,597	43,271		69,868	
Deposits held in money market funds	347	3,978		4,325	
	$ 26,944	$ 47,249	$	$ 74,193	$
Liabilities:					
Interest rate swaps	$	$ (2,649)	$	$ (2,649)	$
Non-recurring:					
Assets:					
Hospital available for sale	$	$	$ 105	$ 105	$ (569)
Property and equipment			286	286	(3,630)
Goodwill skilled nursing rehabilitation services					(107,899)
Intangible assets Medicare license					(2,530)
	$	$	$ 391	$ 391	$ (114,628)
Liabilities	$	$	$	$	$

Recurring measurements

The Company s available-for-sale investments held by its limited purpose insurance subsidiary consist of debt securities, equities, money market funds and certificates of deposit. These available-for-sale investments and the insurance subsidiary s cash and cash equivalents of $174.9 million as of September 30, 2013 and $136.5 million as of December 31, 2012, classified as insurance subsidiary investments, are maintained for the payment of claims and expenses related to professional liability and workers compensation risks.

The Company also has available-for-sale investments totaling $3.5 million as of September 30, 2013 and $3.7 million as of December 31, 2012 related to a deferred compensation plan that is maintained for certain of the Company s current and former employees.

The fair value of actively traded debt and equity securities and money market funds are based upon quoted market prices and are generally classified as Level 1. The fair value of inactively traded debt securities and certificates of deposit are based upon either quoted market prices of similar securities or observable inputs such as interest rates using either a market or income valuation approach and are generally classified as Level 2. The Company s investment advisors obtain and review pricing for each security. The Company is responsible for the determination of fair value and as such the Company reviews the pricing information from its advisors in determining reasonable estimates of fair value. Based upon the Company s internal review procedures, there were no adjustments to the prices during the three or nine months ended September 30, 2013 or September 30, 2012.

The Company s deposits held in money market funds consist primarily of cash and cash equivalents held for general corporate purposes.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 13 FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (continued)

Recurring measurements (Continued)

The fair value of the derivative liability associated with the interest rate swaps is estimated using industry-standard valuation models, which are Level 2 measurements. Such models project future cash flows and discount the future amounts to a present value using market-based observable inputs, including interest rate curves.

The following table presents the carrying amounts and estimated fair values of the Company s financial instruments. The carrying value is equal to fair value for financial instruments that are based upon quoted market prices or current market rates. The Company s long-term debt is based upon Level 2 inputs.

	September 30, 2013		December 31, 2012	
(In thousands)	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	$ 44,579	$ 44,579	$ 50,007	$ 50,007
Cash restricted	3,953	3,953	5,197	5,197
Insurance subsidiary investments	243,602	243,602	202,592	202,592
Tax refund escrow investments	204	204	207	207
Long-term debt, including amounts due within one year (excluding capital lease obligations totaling $10,000 and $0.6 million at September 30, 2013 and December 31, 2012, respectively)	1,390,600	1,432,470	1,657,039	1,630,649

Non-recurring measurements

In the third quarter of 2013, the Company recorded an asset impairment charge of $7.9 million related to leasehold improvements of the 2013 Expiring Facilities. These charges reflect the amount by which the carrying value exceeded its estimated fair value. The fair value of property and equipment was measured using Level 3 inputs such as replacement costs adjusted for depreciation, economic obsolescence and inflation.

In the third quarter of 2013, the Company reviewed the long-lived assets related to the planned divestiture and pending offer for a closed TC hospital held for sale and determined its property and equipment was impaired. As a result, the Company recorded a pretax impairment charge of $0.9 million in other operating expenses in continuing operations in the third quarter of 2013. The fair value of the assets were measured using a Level 3 input of the pending offer.

During the three and nine months ended September 30, 2013, the Company reduced the fair value of a hospital held for sale based upon a pending offer, which resulted in a pretax loss of $1.0 million and $2.3 million, respectively, recorded in discontinued operations. The primary reason for the reduction was to compensate for certain real estate

restrictions associated with the property. The fair value of the asset was measured using a Level 3 input of the pending offer.

CMS issued final rules which, among other things, significantly reduced Medicare payments to nursing centers and changed the reimbursement for the provision for group rehabilitation therapy services to Medicare beneficiaries beginning October 1, 2011 (the 2011 CMS Rules). The Company recorded pretax impairment charges aggregating $1.1 million and $2.2 million in the third quarter of 2013 and for the nine months ended September 30, 2013, respectively, for property and equipment expenditures in the nursing center asset groups that were determined to be impaired by the 2011 CMS Rules. These charges reflected the amount by which the carrying value of certain assets exceeded their estimated fair value. The fair value of property and equipment was measured using Level 3 inputs such as replacement costs factoring in depreciation, economic obsolesce and inflation trends.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The accompanying unaudited condensed consolidating financial information has been prepared and presented pursuant to SEC Regulation S-X, Rule 3-10, Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered. The Company s $550 million of senior notes due 2019 (the Notes) issued on June 1, 2011 are fully and unconditionally guaranteed, subject to certain customary release provisions, by substantially all of the Company s domestic 100% owned subsidiaries. The equity method has been used with respect to the parent company s investment in subsidiaries.

The following unaudited condensed consolidating financial data present the financial position of the parent company/issuer, the guarantor subsidiaries and the non-guarantor subsidiaries as of September 30, 2013 and December 31, 2012, and the respective results of operations and cash flows for the three and nine months ended September 30, 2013 and September 30, 2012.

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

	Three months ended September 30, 2013				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$	$ 1,087,228	$ 140,267	$ (29,022)	$ 1,198,473
Salaries, wages and benefits		683,376	50,229		733,605
Supplies		73,057	8,755		81,812
Rent		68,467	10,802		79,269
Other operating expenses		234,857	64,092	(29,022)	269,927
Other (income) expense		373	(321)		52
Impairment charges		441			441
Depreciation and amortization		35,092	2,499		37,591
Management fees		(3,379)	3,379		
Intercompany interest (income) expense from affiliates	(24,404)	15,215	9,189		
Interest expense	25,567	18	48		25,633
Investment income		(69)	(1,166)		(1,235)
Equity in net loss of consolidating affiliates	106,237			(106,237)	
	107,400	1,107,448	147,506	(135,259)	1,227,095
Loss from continuing operations before income taxes	(107,400)	(20,220)	(7,239)	106,237	(28,622)

Provision (benefit) for income taxes	(402)	(8,774)	173		(9,003)
Loss from continuing operations	(106,998)	(11,446)	(7,412)	106,237	(19,619)
Discontinued operations, net of income taxes:					
Loss from operations		(21,609)			(21,609)
Loss on divestiture of operations		(65,016)			(65,016)
Loss from discontinued operations		(86,625)			(86,625)
Net loss	(106,998)	(98,071)	(7,412)	106,237	(106,244)
Earnings attributable to noncontrolling interests			(754)		(754)
Loss attributable to Kindred	$ (106,998)	$ (98,071)	$ (8,166)	$ 106,237	$ (106,998)
Comprehensive loss	$ (107,607)	$ (98,071)	$ (7,808)	$ 106,633	$ (106,853)
Comprehensive loss attributable to Kindred	$ (107,607)	$ (98,071)	$ (8,562)	$ 106,633	$ (107,607)

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss) (Continued)

	Three months ended September 30, 2012				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$	$ 1,131,519	$ 119,752	$ (25,112)	$ 1,226,159
Salaries, wages and benefits		708,763	45,998		754,761
Supplies		76,297	8,832		85,129
Rent		71,740	7,572		79,312
Other operating expenses		207,367	47,821	(25,112)	230,076
Other (income) expense		(4,336)	1,158		(3,178)
Impairment charges		406			406
Depreciation and amortization		38,719	2,585		41,304
Management fees		(2,994)	2,994		
Intercompany interest (income) expense from affiliates	(26,840)	18,696	8,144		
Interest expense (income)	26,544	(40)	159		26,663
Investment income		(22)	(190)		(212)
Equity in net income of consolidating affiliates	(7,355)			7,355	
	(7,651)	1,114,596	125,073	(17,757)	1,214,261
Income (loss) from continuing operations before income taxes	7,651	16,923	(5,321)	(7,355)	11,898
Provision for income taxes	85	4,801	184		5,070
Income (loss) from continuing operations	7,566	12,122	(5,505)	(7,355)	6,828
Discontinued operations, net of income taxes:					
Income from operations		3,059			3,059
Loss on divestiture of operations		(2,280)			(2,280)
Income from discontinued operations		779			779
Net income (loss)	7,566	12,901	(5,505)	(7,355)	7,607
Earnings attributable to noncontrolling interests			(41)		(41)

Income (loss) attributable to Kindred	$ 7,566	$ 12,901	$ (5,546)	$ (7,355)	$ 7,566
Comprehensive income (loss)	$ 7,919	$ 12,901	$ (5,142)	$ (7,718)	$ 7,960
Comprehensive income (loss) attributable to Kindred	$ 7,919	$ 12,901	$ (5,183)	$ (7,718)	$ 7,919

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss) (Continued)

	Nine months ended September 30, 2013				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$	$ 3,405,073	$ 387,448	$ (87,065)	$ 3,705,456
Salaries, wages and benefits		2,125,173	139,352		2,264,525
Supplies		226,090	25,582		251,672
Rent		210,822	27,293		238,115
Other operating expenses		664,836	167,785	(87,065)	745,556
Other (income) expense		191	(1,174)		(983)
Impairment charges		1,085			1,085
Depreciation and amortization		111,437	8,435		119,872
Management fees		(9,655)	9,655		
Intercompany interest (income) expense from affiliates	(78,315)	51,816	26,499		
Interest expense	82,686	49	153		82,888
Investment income		(195)	(2,603)		(2,798)
Equity in net loss of consolidating affiliates	99,545			(99,545)	
	103,916	3,381,649	400,977	(186,610)	3,699,932
Income (loss) from continuing operations before income taxes	(103,916)	23,424	(13,529)	99,545	5,524
Provision (benefit) for income taxes	(1,720)	4,935	1,073		4,288
Income (loss) from continuing operations	(102,196)	18,489	(14,602)	99,545	1,236
Discontinued operations, net of income taxes:					
Loss from operations		(24,287)			(24,287)
Loss on divestiture of operations		(77,893)			(77,893)
Loss from discontinued operations		(102,180)			(102,180)
Net loss	(102,196)	(83,691)	(14,602)	99,545	(100,944)
Earnings attributable to noncontrolling interests			(1,252)		(1,252)

Loss attributable to Kindred	$ (102,196)	$ (83,691)	$ (15,854)	$ 99,545	$ (102,196)
Comprehensive loss	$ (101,946)	$ (83,691)	$ (14,661)	$ 99,604	$ (100,694)
Comprehensive loss attributable to Kindred	$ (101,946)	$ (83,691)	$ (15,913)	$ 99,604	$ (101,946)

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss) (Continued)

	Nine months ended September 30, 2012				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$	$ 3,439,095	$ 361,391	$ (75,335)	$ 3,725,151
Salaries, wages and benefits		2,152,031	130,772		2,282,803
Supplies		233,615	27,971		261,586
Rent		211,469	22,976		234,445
Other operating expenses		629,172	145,855	(75,335)	699,692
Other income		(9,447)	(32)		(9,479)
Impairment charges		1,015			1,015
Depreciation and amortization		112,650	8,779		121,429
Management fees		(9,371)	9,371		
Intercompany interest (income) expense from affiliates	(83,087)	58,283	24,804		
Interest expense (income)	79,405	119	422		79,946
Investment income		(88)	(665)		(753)
Equity in net income of consolidating affiliates	(38,527)			38,527	
	(42,209)	3,379,448	370,253	(36,808)	3,670,684
Income (loss) from continuing operations before income taxes	42,209	59,647	(8,862)	(38,527)	54,467
Provision for income taxes	950	21,457	519		22,926
Income (loss) from continuing operations	41,259	38,190	(9,381)	(38,527)	31,541
Discontinued operations, net of income taxes:					
Income from operations		13,777			13,777
Loss on divestiture of operations		(3,806)			(3,806)
Income from discontinued operations		9,971			9,971
Net income (loss)	41,259	48,161	(9,381)	(38,527)	41,512
Earnings attributable to noncontrolling interests			(253)		(253)

Income (loss) attributable to Kindred	$ 41,259	$ 48,161	$ (9,634)	$ (38,527)	$ 41,259
Comprehensive income (loss)	$ 41,636	$ 48,161	$ (8,421)	$ (39,487)	$ 41,889
Comprehensive income (loss) attributable to Kindred	$ 41,636	$ 48,161	$ (8,674)	$ (39,487)	$ 41,636

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Balance Sheet

	As of September 30, 2013				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$	$ 33,063	$ 11,516	$	$ 44,579
Cash restricted		3,953			3,953
Insurance subsidiary investments			93,686		93,686
Accounts receivable, net		839,397	90,534		929,931
Inventories		23,358	2,933		26,291
Deferred tax assets		16,543			16,543
Income taxes		42,451	858		43,309
Other		33,764	6,268		40,032
		992,529	205,795		1,198,324
Property and equipment, net		815,847	49,145		864,992
Goodwill		684,623	291,988		976,611
Intangible assets, net		382,781	22,990		405,771
Assets held for sale		22,092			22,092
Insurance subsidiary investments			149,916		149,916
Deferred tax assets			13,964	(7,714)	6,250
Investment in subsidiaries	122,195			(122,195)	
Intercompany	2,394,306			(2,394,306)	
Other	45,379	126,743	68,531		240,653
	$ 2,561,880	$ 3,024,615	$ 802,329	$ (2,524,215)	$ 3,864,609
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$	$ 148,330	$ 20,887	$	$ 169,217
Salaries, wages and other compensation		309,721	44,295		354,016
Due to third party payors		52,134			52,134
Professional liability risks		3,427	56,012		59,439

Other accrued liabilities	24,524	149,052	11,205		184,781
Long-term debt due within one year	7,875	107	243		8,225
	32,399	662,771	132,642		827,812
Long-term debt	1,378,330	277	3,778		1,382,385
Intercompany		2,035,738	358,568	(2,394,306)	
Professional liability risks		76,854	169,628		246,482
Deferred tax liabilities		7,714		(7,714)	
Deferred credits and other liabilities		137,266	82,936		220,202
Commitments and contingencies					
Equity:					
Stockholders equity	1,151,151	103,995	18,200	(122,195)	1,151,151
Noncontrolling interests			36,577		36,577
	1,151,151	103,995	54,777	(122,195)	1,187,728
	$ 2,561,880	$ 3,024,615	$ 802,329	$ (2,524,215)	$ 3,864,609

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Balance Sheet (Continued)

	As of December 31, 2012				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$	$ 37,370	$ 12,637	$	$ 50,007
Cash restricted		5,197			5,197
Insurance subsidiary investments			86,168		86,168
Accounts receivable, net		940,524	98,081		1,038,605
Inventories		29,023	2,998		32,021
Deferred tax assets		12,663			12,663
Income taxes		13,187	386		13,573
Other		15,118	20,414		35,532
		1,053,082	220,684		1,273,766
Property and equipment, net		1,090,523	52,603		1,143,126
Goodwill		771,533	269,733		1,041,266
Intangible assets, net		417,092	22,675		439,767
Assets held for sale		4,131			4,131
Insurance subsidiary investments			116,424		116,424
Investment in subsidiaries	221,799			(221,799)	
Intercompany	2,655,242			(2,655,242)	
Deferred tax assets	1,040		13,932	(14,972)	
Other	47,364	108,143	63,959		219,466
	$ 2,925,445	$ 3,444,504	$ 760,010	$ (2,892,013)	$ 4,237,946
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$ 168	$ 195,268	$ 15,232	$	$ 210,668
Salaries, wages and other compensation		345,223	43,786		389,009
Due to third party payors		35,420			35,420
Professional liability risks		3,623	50,465		54,088
Other accrued liabilities	16,724	111,113	9,367		137,204
	8,000	102	840		8,942

Long-term debt due within one year					
	24,892	690,749	119,690		835,331
Long-term debt	1,644,394	358	3,954		1,648,706
Intercompany		2,328,711	326,531	(2,655,242)	
Professional liability risks		68,116	168,514		236,630
Deferred tax liabilities		24,736		(14,972)	9,764
Deferred credits and other liabilities		143,722	70,949		214,671
Commitments and contingencies					
Equity:					
Stockholders equity	1,256,159	188,112	33,687	(221,799)	1,256,159
Noncontrolling interests			36,685		36,685
	1,256,159	188,112	70,372	(221,799)	1,292,844
	$ 2,925,445	$ 3,444,504	$ 760,010	$ (2,892,013)	$ 4,237,946

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Cash Flows

	Three months ended September 30, 2013				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by operating activities	$ 12,387	$ 90,534	$ 7,829	$	$ 110,750
Cash flows from investing activities:					
Routine capital expenditures		(22,520)	(632)		(23,152)
Development capital expenditures		(3,135)	(100)		(3,235)
Acquisitions, net of cash acquired		(11,771)	(402)		(12,173)
Acquisition deposit		(14,675)			(14,675)
Sale of assets		236,397			236,397
Purchase of insurance subsidiary investments			(7,765)		(7,765)
Sale of insurance subsidiary investments			9,899		9,899
Net change in insurance subsidiary cash and cash equivalents			(1,416)		(1,416)
Change in other investments		(140)			(140)
Other		79			79
Net cash provided by (used in) investing activities		184,235	(416)		183,819
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	238,900				238,900
Repayment of borrowings under revolving credit	(519,200)				(519,200)
Repayment of other long-term debt		(25)	(67)		(92)
Payment of deferred financing costs	(683)				(683)
Distribution made to noncontrolling interests			(118)		(118)
Issuance of common stock	222				222
Dividends paid	(6,499)				(6,499)
Other		53			53

Net change in intercompany accounts	274,873	(270,921)	(3,952)		
Net cash provided by (used in) financing activities	(12,387)	(270,893)	(4,137)		(287,417)
Change in cash and cash equivalents		3,876	3,276		7,152
Cash and cash equivalents at beginning of period		29,187	8,240		37,427
Cash and cash equivalents at end of period	$	$ 33,063	$ 11,516	$	$ 44,579

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Cash Flows (Continued)

	Three months ended September 30, 2012				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by operating activities	$ 918	$ 126,935	$ 13,636	$	$ 141,489
Cash flows from investing activities:					
Routine capital expenditures		(24,140)	(1,799)		(25,939)
Development capital expenditures		(13,702)	(1,475)		(15,177)
Acquisitions, net of cash acquired		(71,440)			(71,440)
Purchase of insurance subsidiary investments			(9,692)		(9,692)
Sale of insurance subsidiary investments			8,063		8,063
Net change in insurance subsidiary cash and cash equivalents			(685)		(685)
Change in other investments		1,003			1,003
Other		(25)			(25)
Net cash used in investing activities		(108,304)	(5,588)		(113,892)
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	364,600				364,600
Repayment of borrowings under revolving credit	(390,400)				(390,400)
Repayment of other long-term debt	(1,750)	(24)	(891)		(2,665)
Payment of deferred financing costs	(288)				(288)
Purchase of noncontrolling interests			(715)		(715)
Net change in intercompany accounts	26,920	(22,053)	(4,867)		
Net cash used in financing activities	(918)	(22,077)	(6,473)		(29,468)
Change in cash and cash equivalents		(3,446)	1,575		(1,871)
Cash and cash equivalents at beginning of period		30,773	6,793		37,566
Cash and cash equivalents at end of period	$	$ 27,327	$ 8,368	$	$ 35,695

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Cash Flows (Continued)

	Nine months ended September 30, 2013				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by operating activities	$ 6,102	$ 162,621	$ 20,494	$	$ 189,217
Cash flows from investing activities:					
Routine capital expenditures		(59,203)	(3,749)		(62,952)
Development capital expenditures		(10,091)	(618)		(10,709)
Acquisitions, net of cash acquired		(38,704)	(402)		(39,106)
Acquisition deposit		(14,675)			(14,675)
Sale of assets		248,700			248,700
Purchase of insurance subsidiary investments			(30,360)		(30,360)
Sale of insurance subsidiary investments			35,427		35,427
Net change in insurance subsidiary cash and cash equivalents			(44,294)		(44,294)
Change in other investments		218			218
Capital contribution to insurance subsidiary		(14,220)		14,220	
Other		(142)			(142)
Net cash provided by (used in) investing activities		111,883	(43,996)	14,220	82,107
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	1,100,300				1,100,300
Repayment of borrowings under revolving credit	(1,363,600)				(1,363,600)
Repayment of other long-term debt	(3,969)	(76)	(773)		(4,818)

Payment of deferred financing costs	(1,340)				(1,340)
Distribution made to noncontrolling interests			(1,628)		(1,628)
Issuance of common stock	429				429
Capital contribution to insurance subsidiary			14,220	(14,220)	
Dividends paid	(6,499)				(6,499)
Other		404			404
Net change in intercompany accounts	268,577	(279,139)	10,562		
Net cash provided by (used in) financing activities	(6,102)	(278,811)	22,381	(14,220)	(276,752)
Change in cash and cash equivalents		(4,307)	(1,121)		(5,428)
Cash and cash equivalents at beginning of period		37,370	12,637		50,007
Cash and cash equivalents at end of period	$	$ 33,063	$ 11,516	$	$ 44,579

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Cash Flows (Continued)

	Nine months ended September 30, 2012				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by operating activities	$ 7,966	$ 163,765	$ 19,356	$	$ 191,087
Cash flows from investing activities:					
Routine capital expenditures		(71,211)	(5,593)		(76,804)
Development capital expenditures		(34,734)	(3,441)		(38,175)
Acquisitions, net of cash acquired		(139,308)			(139,308)
Sale of assets		1,110			1,110
Purchase of insurance subsidiary investments			(30,890)		(30,890)
Sale of insurance subsidiary investments			30,073		30,073
Net change in insurance subsidiary cash and cash equivalents			(15,171)		(15,171)
Change in other investments		1,454			1,454
Capital contribution to insurance subsidiary		(8,600)		8,600	
Other		(1,029)			(1,029)
Net cash used in investing activities		(252,318)	(25,022)	8,600	(268,740)
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	1,329,300				1,329,300
Repayment of borrowings under revolving credit	(1,244,900)				(1,244,900)
Repayment of other long-term debt	(5,250)	(70)	(2,656)		(7,976)
Payment of deferred financing costs	(601)				(601)

Contribution made by noncontrolling interests			200		200
Distribution made to noncontrolling interests			(3,521)		(3,521)
Purchase of noncontrolling interests			(715)		(715)
Net change in intercompany accounts	(86,515)	94,125	(7,610)		
Capital contribution to insurance subsidiary			8,600	(8,600)	
Net cash provided by (used in) financing activities	(7,966)	94,055	(5,702)	(8,600)	71,787
Change in cash and cash equivalents		5,502	(11,368)		(5,866)
Cash and cash equivalents at beginning of period		21,825	19,736		41,561
Cash and cash equivalents at end of period	$	$ 27,327	$ 8,368	$	$ 35,695

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 15 LEGAL AND REGULATORY PROCEEDINGS

The Company provides services in a highly regulated industry and is subject to various legal actions (some of which are not insured) and regulatory and other governmental and internal audits and investigations from time to time. These matters could (1) require the Company to pay substantial damages, fines, penalties or amounts in judgments or settlements, which individually or in the aggregate could exceed amounts, if any, that may be recovered under the Company s insurance policies where coverage applies and is available; (2) cause the Company to incur substantial expenses; (3) require significant time and attention from the Company s management; (4) subject the Company to sanctions including possible exclusions from the Medicare and Medicaid programs; and (5) cause the Company to close or sell one or more facilities or otherwise modify the way the Company conducts business. The ultimate resolution of these matters, whether as a result of litigation or settlement, could have a material adverse effect on the Company s business, financial position, results of operations and liquidity.

In accordance with authoritative accounting guidance related to loss contingencies, the Company records an accrued liability for litigation and regulatory matters that are both probable and can be reasonably estimated. Additional losses in excess of amounts accrued may be reasonably possible. The Company reviews loss contingencies that are reasonably possible and determines whether an estimate of the possible loss or range of loss, individually or in aggregate, can be disclosed in the Company s consolidated financial statements. These estimates are based upon currently available information for those legal and regulatory proceedings in which the Company is involved, taking into account the Company s best estimate of losses for those matters for which such estimate can be made. The Company s estimates involve significant judgment, given that (1) these legal and regulatory proceedings are in early stages; (2) discovery may not be completed; (3) damages sought in these legal and regulatory proceedings can be unsubstantiated or indeterminate; (4) the matters present legal uncertainties or evolving areas of law; (5) there are often significant facts in dispute; and/or (6) there is a wide range of possible outcomes. Accordingly, the Company s estimated loss or range of loss may change from time to time, and actual losses may be more or less than the current estimate. At this time, except as otherwise specifically noted, no estimate of the possible loss or range of loss, individually or in the aggregate, in excess of the amounts accrued, if any, can be made regarding the matters described below.

Set forth below are descriptions of the Company s significant legal proceedings.

Medicare and Medicaid payment reviews, audits and investigations as a result of the Company s participation in the Medicare and Medicaid programs, the Company faces and is currently subject to various governmental and internal reviews, audits and investigations to verify the Company s compliance with these programs and applicable laws and regulations. The Company is routinely subject to audits under various government programs, such as the CMS Recovery Audit Contractor program, in which third party firms engaged by CMS conduct extensive reviews of claims data and medical and other records to identify potential improper payments to healthcare providers under the Medicare program. In addition, the Company, like other hospitals, nursing center operators and rehabilitation therapy service contractors, is subject to ongoing investigations by the U.S. Department of Health and Human Services Office of Inspector General (the OIG) into the billing of rehabilitation services provided to Medicare patients and general compliance with conditions of participation in the Medicare and Medicaid programs. Private pay sources such as third party insurance and managed care entities also often reserve the right to conduct audits. The Company s costs to respond to and defend any such reviews, audits and investigations can be significant and are likely to increase in the

current enforcement environment. These audits and investigations may require the Company to refund or retroactively adjust amounts that have been paid under the relevant government program or by other payors. Further, an adverse review, audit or investigation also could result in other adverse consequences, particularly if the underlying conduct is found to be pervasive or systemic. These consequences include (1) state or federal agencies imposing fines, penalties and other sanctions on the Company; (2) loss of the Company s right to participate in the Medicare or Medicaid programs or one or more third party payor networks; and/or (3) damage to the Company s reputation in various markets, which could adversely affect the Company s ability to attract patients, residents and employees.

Whistleblower lawsuits the Company is also subject to qui tam or whistleblower lawsuits under the False Claims Act and comparable state laws for allegedly submitting fraudulent bills for services to the Medicare and Medicaid programs. These lawsuits involve monetary damages, fines, attorneys fees and the award of bounties to private qui tam plaintiffs who successfully bring these lawsuits and to the respective government programs. The Company also could be subject to civil penalties (including the loss of the Company s licenses to operate one or more facilities or healthcare activities), criminal penalties (for violations of certain laws and regulations), and exclusion of one or more facilities or healthcare activities from participation in the Medicare, Medicaid and other federal and state healthcare programs. The lawsuits are in various stages of adjudication or investigation and involve a wide variety of claims and potential outcomes.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 15 LEGAL AND REGULATORY PROCEEDINGS (Continued)

A whistleblower lawsuit is currently pending against RehabCare Group, Inc. (RehabCare), a therapy services company acquired by the Company on June 1, 2011, in federal district court for the Eastern District of Missouri. The lawsuit pertains to a subcontractor arrangement entered into in 2006 by RehabCare and another therapy services provider, and fees paid under and in connection with the transaction. The complaint alleges violations of the federal civil False Claims Act based upon an underlying claim that the transaction violated the federal Anti-Kickback Statute. In July 2013, all parties filed motions for summary judgment, which were denied on August 30, 2013. The trial on the matter began on September 23, 2013, but has been recessed until February 3, 2014 while the parties continue settlement discussions. Any potential settlement of this lawsuit would be subject to, among other items, the negotiation and execution of a definitive settlement agreement, any necessary approvals by the parties, approval of the OIG (which may include other remedial actions), and final court approval of the related settlement agreement. The Company disputes the allegations in the complaint and continues to defend this lawsuit vigorously. The United States is seeking single damages in the amount of approximately $226 million, treble damages, per claim penalties of $5,500 to $11,000 for each claim submitted, other unspecified damages, attorneys fees and costs. Based upon the results of certain pre-trial motions, new facts associated with the case and settlement discussions occurring in September 2013, the Company recorded an additional $23 million loss provision in the third quarter of 2013 (for a total loss reserve of $25 million) related to this matter. The Company continues to evaluate the loss provision in light of potentially relevant factual and legal developments, including information learned through rulings on dispositive motions, settlement discussions and other rulings. The expected loss reserve is based upon currently available information and is subject to significant judgment and a variety of assumptions, and known and unknown uncertainties. Given the uncertainty of litigation, the actual loss may vary significantly from the current reserve, which does not represent the Company s maximum loss exposure. At this time, no estimate of the possible loss or range of loss, in excess of the amount accrued, can be made regarding this lawsuit.

Employment-related lawsuits the Company s operations are subject to a variety of federal and state employment-related laws and regulations, including but not limited to the U.S. Fair Labor Standards Act, regulations of the Equal Employment Opportunity Commission, the Office of Civil Rights and state attorneys general, federal and state wage and hour laws and a variety of laws enacted by the federal and state governments that govern these and other employment-related matters. Accordingly, the Company is currently subject to employee-related claims, class action and other lawsuits and proceedings in connection with the Company s operations, including but not limited to those related to alleged wrongful discharge, illegal discrimination and violations of equal employment and federal and state wage and hour laws. Because labor represents such a large portion of the Company s operating costs, non-compliance with these evolving federal and state laws and regulations could subject the Company to significant back pay awards, fines and additional lawsuits and proceedings. These claims, lawsuits and proceedings are in various stages of adjudication or investigation and involve a wide variety of claims and potential outcomes.

Four wage and hour class action lawsuits are currently pending against the Company in federal district court for the Central District of California, and are being addressed together by the court. Each case pertains to alleged errors made by the Company with respect to regular pay and overtime pay calculations, waiting times, meal period waivers and wage statements under California law. On March 13, 2013, the court conditionally certified five classes of the seven total classes sought for certification for discovery purposes and declined to certify two others. Notice of class action certification and class members right to opt out of the lawsuit was mailed to all of the Company s current and former

California hospital employees with an opt-out deadline of July 27, 2013. The Company intends to vigorously defend these claims and has taken affirmative steps to ensure compliance with applicable California laws.

A wage and hour class action lawsuit against the Company alleging violations of federal and state wage and hour laws is pending in federal district court for the Northern District of Illinois. This lawsuit pertains to the Company s previous automatic meal break deduction practice for non-exempt employees in the Company s hospitals located outside California. The court granted conditional class certification in part on June 11, 2013. This lawsuit has been settled in principle by the Company s agreement to pay $0.7 million to claimants from the Company s five Illinois hospitals, plaintiffs attorney s fees and certain administrative costs, subject to reaching a written settlement agreement and obtaining court approval.

Based upon available information, the Company recorded an additional $0.7 million loss provision in the third quarter of 2013 (for a total loss reserve of $5.7 million) related to these wage and hour lawsuits. The Company continues to evaluate the loss provision in light of potentially relevant factual and legal developments, including information learned through rulings on dispositive motions, settlement discussions and other rulings. The expected loss reserve is based upon currently available information and is subject to significant judgment and a variety of assumptions, and known and unknown uncertainties. Given the uncertainty of litigation, the actual loss may vary significantly from the current reserve, which does not represent the Company s maximum loss exposure. At this time, no estimate of the possible loss or range of loss, in excess of the amount accrued, can be made regarding these lawsuits.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 15 LEGAL AND REGULATORY PROCEEDINGS (Continued)

Minimum staffing lawsuits various states in which the Company operates hospitals and nursing centers have established minimum staffing requirements or may establish minimum staffing requirements in the future. While the Company seeks to comply with all applicable staffing requirements, the regulations in this area are complex and the Company may experience compliance issues from time to time. Failure to comply with such minimum staffing requirements may result in one or more facilities failing to meet the conditions of participation under relevant federal and state healthcare programs and the imposition of significant fines, damages or other sanctions.

Ordinary course matters in addition to the matters described above, the Company is subject to investigations, claims and lawsuits in the ordinary course of business, including professional liability claims and investigations resulting from the Company s obligation to self-report suspected violations of law by the Company, particularly in the Company s hospital and nursing center operations. In many of these claims, plaintiffs attorneys are seeking significant fines and compensatory and punitive damages, along with attorneys fees. The Company maintains professional and general liability insurance in amounts and coverage that management believes are sufficient for the Company s operations. However, the Company s insurance may not cover all claims against the Company or the full extent of the Company s liability.

NOTE 16 SUBSEQUENT EVENTS

On November 4, 2013, the Company announced that it has signed a definitive agreement to acquire Senior Home Care, Inc. (Senior Home Care) for a purchase price of $95 million. The Company expects to finance the transaction with operating cash flows and proceeds from its ABL Facility.

Senior Home Care is a home health provider that operates through 47 locations in Florida and Louisiana.

The transaction with Senior Home Care is subject to several regulatory approvals and other customary conditions to closing. The Company expects to close the transaction in the fourth quarter of 2013.

On November 5, 2013, the Company announced that its subsidiary has signed a definitive agreement with HCP, Inc. and its affiliates (HCP) to acquire the real estate associated with nine nursing centers that it currently leases from HCP for approximately $83 million. The annual lease payments for these nursing centers are approximately $9 million. The transaction with HCP is subject to several conditions to closing. The Company expects to close the transaction in the fourth quarter of 2013.

On November 5, 2013, the Company announced that its Board of Directors approved the payment of a quarterly cash dividend to its shareholders of $0.12 per common share to be paid on December 9, 2013 to shareholders of record as of the close of business on November 18, 2013. Future declarations of quarterly dividends will be subject to the approval of Kindred s Board of Directors.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement

This Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). All statements regarding the Company s expected future financial position, results of operations, cash flows, financing plans, business strategy, budgets, capital expenditures, competitive positions, growth opportunities, plans and objectives of management and statements containing the words such as anticipate, approximate, believe, plan, estimate, expect, project, could, should, will, intend, may and other similar expressions, are forward-loo statements.

Such forward-looking statements are inherently uncertain, and stockholders and other potential investors must recognize that actual results may differ materially from the Company s expectations as a result of a variety of factors, including, without limitation, those discussed below. Such forward-looking statements are based upon management s current expectations and include known and unknown risks, uncertainties and other factors, many of which the Company is unable to predict or control, that may cause the Company s actual results or performance to differ materially from any future results or performance expressed or implied by such forward-looking statements. These statements involve risks, uncertainties and other factors discussed below and detailed from time to time in the Company s filings with the SEC. Factors that may affect the Company s plans, results or stock price include, without limitation:

the impact of healthcare reform, which will initiate significant changes to the United States healthcare system, including potential material changes to the delivery of healthcare services and the reimbursement paid for such services by the government or other third party payors, including reforms resulting from the Patient Protection and Affordable Care Act and the Healthcare Education and Reconciliation Act (collectively, the ACA) or future deficit reduction measures adopted at the federal or state level. Healthcare reform is affecting each of the Company s businesses in some manner. Potential future efforts in the U.S. Congress to repeal, amend, modify or retract funding for various aspects of the ACA create additional uncertainty about the ultimate impact of the ACA on the Company and the healthcare industry. Due to the substantial regulatory changes that will need to be implemented by CMS and others, and the numerous processes required to implement these reforms, the Company cannot predict which healthcare initiatives will be implemented at the federal or state level, the timing of any such reforms, or the effect such reforms or any other future legislation or regulation will have on the Company s business, financial position, results of operations and liquidity,

the impact of final rules issued by CMS on August 1, 2012 (the 2012 CMS Rules) which, among other things, will reduce Medicare reimbursement to the Company s TC hospitals in 2013 and beyond by imposing a budget neutrality adjustment and modifying the short-stay outlier rules,

the impact of the 2011 CMS Rules which significantly reduced Medicare reimbursement to the Company s nursing centers and changed payments for the provision of group therapy services effective October 1, 2011,

the impact of the Budget Control Act of 2011 (as amended by the American Taxpayer Relief Act of 2012 (the Taxpayer Relief Act)) which will automatically reduce federal spending by approximately $1.2 trillion split evenly between domestic and defense spending. An automatic 2% reduction on each claim submitted to Medicare began on April 1, 2013,

the impact of the Taxpayer Relief Act which, among other things, reduces Medicare payments by 50% for subsequent procedures when multiple therapy services are provided on the same day. At this time, the Company believes that the rules related to multiple therapy services will reduce its Medicare revenues by $25 million to $30 million on an annual basis,

changes in the reimbursement rates or the methods or timing of payment from third party payors, including commercial payors and the Medicare and Medicaid programs, changes arising from and related to the Medicare prospective payment system for LTAC hospitals, including potential changes in the Medicare payment rules, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, and changes in Medicare and Medicaid reimbursement for the Company s TC hospitals, nursing centers, IRFs and home health and hospice operations, and the expiration of the Medicare Part B therapy cap exception process,

the effects of additional legislative changes and government regulations, interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare industry,

the ability of the Company s hospitals to adjust to potential LTAC certification and medical necessity reviews,

the costs of defending and insuring against alleged professional liability and other claims (including those related to pending whistleblower and wage and hour class action lawsuits against the Company) and the Company s ability to predict the estimated costs and reserves related to such claims, including the impact of differences in actuarial assumptions and estimates compared to eventual outcomes,

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Cautionary Statement (Continued)

the impact of the Company s significant level of indebtedness on its funding costs, operating flexibility and ability to fund ongoing operations, development capital expenditures or other strategic acquisitions with additional borrowings,

the Company s ability to successfully redeploy its capital and proceeds of asset sales in pursuit of its business strategy and pursue its development activities, including through acquisitions, and successfully integrate new operations, including the realization of anticipated revenues, economies of scale, cost savings and productivity gains associated with such operations, as and when planned, including the potential impact of unanticipated issues, expenses and liabilities associated with those activities,

the Company s ability to pay a dividend as, when and if declared by the Board of Directors, in compliance with applicable laws and the Company s debt and other contractual arrangements,

the failure of the Company s facilities to meet applicable licensure and certification requirements,

the further consolidation and cost containment efforts of managed care organizations and other third party payors,

the Company s ability to meet its rental and debt service obligations,

the Company s ability to operate pursuant to the terms of its debt obligations, and comply with its covenants thereunder, and its ability to operate pursuant to its master lease agreements with Ventas,

the condition of the financial markets, including volatility and weakness in the equity, capital and credit markets, which could limit the availability and terms of debt and equity financing sources to fund the requirements of the Company s businesses, or which could negatively impact the Company s investment portfolio,

the Company s ability to control costs, particularly labor and employee benefit costs,

the Company s ability to successfully reduce or mitigate (by divestiture of operations or otherwise) its exposure to professional liability and other claims,

the Company s obligations under various laws to self-report suspected violations of law by the Company to various government agencies, including any associated obligation to refund overpayments to government payors, fines and other sanctions,

the potential for diversion of management time and resources in seeking to transfer the operations of 60 non-strategic nursing centers currently leased from Ventas,

national and regional economic, financial, business and political conditions, including their effect on the availability and cost of labor, credit, materials and other services,

increased operating costs due to shortages in qualified nurses, therapists and other healthcare personnel,

the Company s ability to attract and retain key executives and other healthcare personnel,

the Company s ability to successfully dispose of unprofitable facilities,

events or circumstances which could result in the impairment of an asset or other charges, such as the impact of the Medicare reimbursement regulations that resulted in the Company recording significant impairment charges in 2012 and 2011,

changes in generally accepted accounting principles or practices, and changes in tax accounting or tax laws (or authoritative interpretations relating to any of these matters), and

the Company s ability to maintain an effective system of internal control over financial reporting.

Many of these factors are beyond the Company s control. The Company cautions investors that any forward-looking statements made by the Company are not guarantees of future performance. The Company disclaims any obligation to update any such factors or to announce publicly the results of any revisions to any of the forward-looking statements to reflect future events or developments.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

General

The accompanying unaudited condensed consolidated financial statements, including the notes thereto, should be read in conjunction with the following discussion and analysis.

The Company is a healthcare services company that through its subsidiaries operates TC hospitals, IRFs, nursing centers, assisted living facilities, a contract rehabilitation services business and a home health and hospice business across the United States. At September 30, 2013, the Company s hospital division operated 102 TC hospitals (7,394 licensed beds) and five IRFs (215 licensed beds) in 22 states. The Company s nursing center division operated 102 nursing centers (13,226 licensed beds) and six assisted living facilities (341 licensed beds) in 22 states. The Company s rehabilitation division provided rehabilitation services primarily in hospitals and long-term care settings. The Company s home health and hospice division provided home health, hospice and private duty services from 105 locations in 11 states.

RehabCare Merger

On June 1, 2011, the Company completed the acquisition of RehabCare (the RehabCare Merger). Upon consummation of the RehabCare Merger, each issued and outstanding share of RehabCare common stock was converted into the right to receive 0.471 of a share of the Company s common stock and $26 per share in cash, without interest (the Merger Consideration). Kindred issued approximately 12 million shares of its common stock in connection with the RehabCare Merger. The purchase price totaled $963 million and was comprised of $662 million in cash and $301 million of Kindred common stock at fair value. The Company also assumed $356 million of long-term debt in the RehabCare Merger, of which $345 million was refinanced on June 1, 2011. The operating results of RehabCare have been included in the accompanying unaudited condensed consolidated financial statements of the Company since June 1, 2011.

Divestitures

During the third quarter of 2013, the Company completed the sale of the Vibra Facilities for $187 million to an affiliate of Vibra. The net proceeds of $180 million from this transaction were used to reduce the Company s borrowings under its ABL Facility.

The Vibra Facilities consist of 14 TC hospitals containing 1,002 licensed beds, one IRF containing 44 licensed beds and one nursing center containing 135 licensed beds. Six of the TC hospitals and the one nursing center were owned facilities. The remaining Vibra Facilities were leased. The Vibra Facilities generated revenues of approximately $272 million and segment operating income of approximately $40 million (excluding the allocation of approximately $8 million of overhead costs) for the year ended December 31, 2012. The Vibra Facilities had aggregate rent expense of approximately $12 million for the year ended December 31, 2012.

The Company recorded a loss on divestiture of $76 million ($63 million net of income taxes) and $94 million ($74 million net of income taxes) during the third quarter of 2013 and for the nine months ended September 30, 2013, respectively, related to the Vibra Facilities. The loss on divestiture included a $69 million write-off of goodwill, which was allocated based upon the relative fair value of the Vibra Facilities, and a $21 million write-off of intangible assets.

On July 31, 2013, the Company completed the sale of the Signature Facilities for $47 million to affiliates of Signature. The proceeds from this transaction were used to reduce the Company s borrowings under its ABL Facility.

The Signature Facilities contain 900 licensed beds. Five of the Signature Facilities were owned facilities and the remaining Signature Facilities were leased. The Signature Facilities generated revenues of approximately $63 million and segment operating income of approximately $11 million (excluding the allocation of approximately $2 million of overhead costs) for the year ended December 31, 2012. The Signature Facilities had aggregate rent expense of approximately $2 million for the year ended December 31, 2012.

The Company recorded a loss on divestiture of $2 million ($1 million net of income taxes) during the third quarter of 2013 related to the Signature Facilities.

The results of operations and losses on divestiture of operations, net of income taxes, for the Signature Facilities and the Vibra Facilities were reclassified to discontinued operations in the third quarter of 2013.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

General (Continued)

Divestitures (Continued)

On April 27, 2012, the Company announced that it would not renew the 2012 Expiring Facilities under operating leases with Ventas that expired on April 30, 2013. The 2012 Expiring Facilities contained 6,140 licensed nursing center beds and generated revenues of approximately $475 million for the year ended December 31, 2012. The annual rent for these facilities approximated $57 million. The Company transferred the operations of all of the 2012 Expiring Facilities to new operators during the nine months ended September 30, 2013. The Company reclassified the results of operations and losses associated with the 2012 Expiring Facilities to discontinued operations, net of income taxes, for all periods presented. The Company received cash proceeds of $13 million for the nine months ended September 30, 2013 for the sale of property and equipment and inventory related to the 2012 Expiring Facilities.

Discontinued operations

In 2013 and in recent years, the Company has completed several strategic divestitures or planned divestitures to improve its future operating results. For accounting purposes, the operating results of these businesses and the losses associated with these transactions have been classified as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all periods presented. Assets held for sale at September 30, 2013 have been measured at the lower of carrying value or estimated fair value less costs of disposal and have been classified as held for sale in the accompanying unaudited condensed consolidated balance sheet.

On September 30, 2013, the Company entered into agreements to renew early its leases with Ventas for the Renewal Facilities and exit the 2013 Expiring Facilities. The current lease term for the Renewal Facilities and the 2013 Expiring Facilities was scheduled to expire in April 2015. Under the terms of the agreements, the lease term for the 2013 Expiring Facilities will expire on September 30, 2014. For accounting purposes, 59 of the 2013 Expiring Facilities qualified as assets held for sale and the Company reflected the operating results as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all historical periods and will reflect the facility scheduled for closure as a discontinued operation upon completion of the exit process. Under the terms of the agreements, the Company will pay $20 million to Ventas in exchange for the early termination of certain leases. The disposal group was measured at its fair value less cost to sell and the Company recorded an asset impairment charge of $8 million related to leasehold improvements in the 2013 Expiring Facilities. These charges were recorded in discontinued operations in the third quarter of 2013 in the accompanying unaudited condensed consolidated statement of operations.

Critical Accounting Policies

Management s discussion and analysis of financial condition and results of operations are based upon the Company s consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the use of estimates and judgments that affect the reported amounts and related disclosures of commitments and contingencies. The Company relies on historical experience and on various other assumptions that management believes to be reasonable under the circumstances to make judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from these estimates.

The Company believes the following critical accounting policies, among others, affect the more significant judgments and estimates used in the preparation of its consolidated financial statements.

Revenue recognition

The Company has agreements with third party payors that provide for payments to each of its operating divisions. These payment arrangements may be based upon prospective rates, reimbursable costs, established charges, discounted charges or per diem payments. Net patient service revenue is recorded at the estimated net realizable amounts from Medicare, Medicaid, Medicare Advantage, other third party payors and individual patients for services rendered. Retroactive adjustments that are likely to result from future examinations by third party payors are accrued on an estimated basis in the period the related services are rendered and adjusted as necessary in future periods based upon new information or final settlements.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Critical Accounting Policies (Continued)

Collectibility of accounts receivable

Accounts receivable consist primarily of amounts due from the Medicare and Medicaid programs, other government programs, managed care health plans, commercial insurance companies, skilled nursing and hospital customers, and individual patients and other customers. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected.

In evaluating the collectibility of accounts receivable, the Company considers a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type, the status of ongoing disputes with third party payors and general industry conditions. Actual collections of accounts receivable in subsequent periods may require changes in the estimated provision for loss. Changes in these estimates are charged or credited to the results of operations in the period of the change.

The provision for doubtful accounts totaled $8 million and $6 million for the third quarter of 2013 and 2012, respectively, and $20 million and $13 million for the nine months ended September 30, 2013 and 2012, respectively.

Allowances for insurance risks

The Company insures a substantial portion of its professional liability risks and workers compensation risks through its limited purpose insurance subsidiary. Provisions for loss for these risks are based upon management s best available information including actuarially determined estimates.

The allowance for professional liability risks includes an estimate of the expected cost to settle reported claims and an amount, based upon past experiences, for losses incurred but not reported. These liabilities are necessarily based upon estimates and, while management believes that the provision for loss is adequate, the ultimate liability may be in excess of, or less than, the amounts recorded. To the extent that expected ultimate claims costs vary from historical provisions for loss, future earnings will be charged or credited.

Provisions for loss for professional liability risks retained by the Company s limited purpose insurance subsidiary have been discounted based upon actuarial estimates of claim payment patterns using a discount rate of 1% to 5% depending upon the policy year. The discount rate was 1% for the 2013 and 2012 policy years. The discount rates are based upon the risk free interest rate for the respective year. Amounts equal to the discounted loss provision are funded annually. The Company does not fund the portion of professional liability risks related to estimated claims that have been incurred but not reported. Accordingly, these liabilities are not discounted. The allowance for professional liability risks aggregated $306 million at September 30, 2013 and $291 million at December 31, 2012. If the Company did not discount any of the allowances for professional liability risks, these balances would have approximated $309 million at September 30, 2013 and $293 million at December 31, 2012.

As a result of deterioration in professional liability and workers compensation underwriting results of the Company s limited purpose insurance subsidiary in 2012 and 2011, the Company made capital contributions of $14 million and $9 million during the nine months ended September 30, 2013 and 2012, respectively, to its limited purpose insurance subsidiary. These transactions were completed in accordance with applicable regulations. Neither capital contribution had any impact on earnings.

Changes in the number of professional liability claims and the cost to settle these claims significantly impact the allowance for professional liability risks. A relatively small variance between the Company s estimated and actual number of claims or average cost per claim could have a material impact, either favorable or unfavorable, on the adequacy of the allowance for professional liability risks. For example, a 1% variance in the allowance for professional liability risks at September 30, 2013 would impact the Company s operating income by approximately $3 million.

The provision for professional liability risks (continuing operations), including the cost of coverage maintained with unaffiliated commercial insurance carriers, aggregated $12 million and $14 million for the third quarter of 2013 and 2012, respectively, and $45 million and $42 million for the nine months ended September 30, 2013 and 2012, respectively.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Critical Accounting Policies (Continued)

Allowances for insurance risks (Continued)

Provisions for loss for workers compensation risks retained by the Company s limited purpose insurance subsidiary are not discounted and amounts equal to the loss provision are funded annually. The allowance for workers compensation risks aggregated $201 million at September 30, 2013 and $193 million at December 31, 2012. The provision for workers compensation risks (continuing operations), including the cost of coverage maintained with unaffiliated commercial insurance carriers, aggregated $8 million and $11 million for the third quarter of 2013 and 2012, respectively, and $30 million and $33 million for the nine months ended September 30, 2013 and 2012, respectively.

Accounting for income taxes

The provision for income taxes is based upon the Company s estimate of annual taxable income or loss for each respective accounting period. The Company recognizes an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets are recovered or liabilities are settled. The Company also recognizes as deferred tax assets the future tax benefits from net operating losses and capital loss carryforwards. A valuation allowance is provided for these deferred tax assets if it is more likely than not that some portion or all of the net deferred tax assets will not be realized.

The Company s effective income tax rate was 31.5% and 42.6% for the third quarter of 2013 and 2012, respectively, and 77.6% and 42.1% for the nine months ended September 30, 2013 and 2012, respectively. The change in the effective tax rate for both periods was primarily related to a non-deductible litigation charge that increased the provision for income taxes by approximately $3 million for both periods.

The Company has recognized deferred tax assets to the extent it is more likely than not they will be realized and a valuation allowance is provided for deferred tax assets to the extent that it is uncertain that the deferred tax asset will be realized. The Company recognized net deferred tax assets totaling $23 million and $3 million at September 30, 2013 and December 31, 2012, respectively.

The Company is subject to various federal and state income tax audits in the ordinary course of business. Such audits could result in increased tax payments, interest and penalties. While the Company believes its tax positions are appropriate, there can be no assurance that the various authorities engaged in the examination of its income tax returns will not challenge the Company s positions.

Valuation of long-lived assets, goodwill and intangible assets

The Company reviews the carrying value of certain long-lived assets and finite lived intangible assets with respect to any events or circumstances that indicate an impairment or an adjustment to the amortization period is necessary. If circumstances suggest that the recorded amounts cannot be recovered based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

In assessing the carrying values of long-lived assets, the Company estimates future cash flows at the lowest level for which there are independent, identifiable cash flows. For this purpose, these cash flows are aggregated based upon the contractual agreements underlying the operation of the facility or group of facilities. Generally, an individual facility is considered the lowest level for which there are independent, identifiable cash flows. However, to the extent that groups of facilities are leased under a master lease agreement in which the operations of a facility and compliance with the lease terms are interdependent upon other facilities in the agreement (including the Company s ability to renew the lease or divest a particular property), the Company defines the group of facilities under a master lease agreement as the lowest level for which there are independent, identifiable cash flows. Accordingly, the estimated cash flows of all facilities within a master lease agreement are aggregated for purposes of evaluating the carrying values of long-lived assets.

The Company s intangible assets with finite lives are amortized in accordance with the authoritative guidance for goodwill and other intangible assets using the straight-line method over their estimated useful lives ranging from two to 20 years.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Critical Accounting Policies (Continued)

Valuation of long-lived assets, goodwill and intangible assets (Continued)

During the third quarter of 2013, the disposal group was measured at its fair value less cost to sell and the Company recorded an asset impairment charge of $8 million ($5 million net of income taxes) related to leasehold improvements in the 2013 Expiring Facilities.

During the nine months ended September 30, 2013, the Company recorded an asset impairment charge of $16 million ($9 million net of income taxes) related to the sale of the Vibra Facilities. In connection with the sale of the Vibra Facilities, the Company also reviewed indefinite-lived intangible assets associated with the Vibra Facilities and the goodwill of the hospital division reporting unit and determined there were no asset impairments on these assets.

In connection with the 2011 CMS Rules, the Company determined that the impact of the 2011 CMS Rules was a triggering event in the third quarter of 2011 and accordingly tested the recoverability of its nursing centers reporting unit goodwill, intangible assets and property and equipment asset groups impacted by the reduced Medicare payments. The Company recorded pretax impairment charges aggregating $1 million ($0.7 million net of income taxes) and $1 million ($0.4 million net of income taxes) in the third quarter of 2013 and 2012, respectively, for property and equipment expenditures in the nursing center asset groups that were determined to be impaired by the 2011 CMS Rules. The Company also recorded pretax impairment charges aggregating $2 million ($1 million net of income taxes) for each of the nine months ended September 30, 2013 and 2012.

All of the previously discussed charges reflected the amount by which the carrying value of certain assets exceeded their estimated fair value.

The loss on divestiture of the Vibra Facilities included a $69 million write-off of goodwill which was allocated based upon the relative fair value of the Vibra Facilities.

In connection with the closing of a TC hospital, the Company recorded a write-off of $1 million of goodwill allocable to the ceased operations.

None of the previously discussed impairment charges or write-offs impacted the Company s cash flows or liquidity.

In accordance with the authoritative guidance for goodwill and other intangible assets, the Company is required to perform an impairment test for goodwill and indefinite-lived intangible assets at least annually or more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. The Company performs its annual goodwill impairment test at the end of each fiscal year for each of its reporting units. A reporting unit is either an operating segment or one level below the operating segment, referred to as a component. When the components within the Company s operating segments have similar economic characteristics, the Company aggregates the components of its operating segments into one reporting unit. Accordingly, the Company has determined that its reporting units are hospitals, nursing centers, skilled nursing rehabilitation services, hospital rehabilitation services, home health and hospice. The carrying value of goodwill for each of the Company s reporting units at September 30, 2013 and December 31, 2012 follows (in thousands):

	September 30, 2013	December 31, 2012
Hospitals	$ 677,557	$ 747,065
Nursing centers		
Rehabilitation division:		
Skilled nursing rehabilitation services		
Hospital rehabilitation services	168,019	168,019
	168,019	168,019
Home health and hospice division:		
Home health	104,125	99,317
Hospice	26,910	26,865
	131,035	126,182
	$ 976,611	$ 1,041,266

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Critical Accounting Policies (Continued)

Valuation of long-lived assets, goodwill and intangible assets (Continued)

The goodwill impairment test involves a two-step process. The first step is a comparison of each reporting unit s fair value to its carrying value. If the carrying value of the reporting unit is greater than its fair value, there is an indication that impairment may exist and the second step must be performed to measure the amount of impairment loss, if any. Based upon the results of the step one impairment test for goodwill for hospitals, hospital rehabilitation services, home health and hospice reporting units for the year ended December 31, 2012, no goodwill impairment charges were recorded in connection with the Company s annual impairment test.

Since quoted market prices for the Company s reporting units are not available, the Company applies judgment in determining the fair value of these reporting units for purposes of performing the goodwill impairment test. The Company relies on widely accepted valuation techniques, including discounted cash flow and market multiple analyses approaches, which capture both the future income potential of the reporting unit and the market behaviors and actions of market participants in the industry that includes the reporting unit. These types of analyses require the Company to make assumptions and estimates regarding future cash flows, industry-specific economic factors and the profitability of future business strategies. The discounted cash flow approach uses a projection of estimated operating results and cash flows that are discounted using a weighted average cost of capital. Under the discounted cash flow approach, the projection uses management s best estimates of economic and market conditions over the projected period for each reporting unit including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. The market multiple analysis estimates fair value by applying cash flow multiples to the reporting unit s operating results. The multiples are derived from comparable publicly traded companies with similar operating and investment characteristics to the reporting units.

The Company has determined that during the nine months ended September 30, 2013, other than the previously discussed decision to terminate the 2013 Expiring Facilities and the sale of the Vibra Facilities, there were no other events or changes in circumstances since December 31, 2012 requiring an interim impairment test. Although the Company has determined that there was no other goodwill or other indefinite-lived intangible asset impairments as of September 30, 2013, adverse changes in the operating environment and related key assumptions used to determine the fair value of the Company s reporting units and indefinite-lived intangible assets or declines in the value of the Company s common stock may result in future impairment charges for a portion or all of these assets. Specifically, if the rate of growth of government and commercial revenues earned by the Company s reporting units were to be less than projected or if healthcare reforms were to negatively impact the Company s business, an impairment charge of a portion or all of these assets may be required.

On July 3, 2013, CMS issued proposed regulations to reduce Medicare reimbursement for home health services by as much as 3.5% in each of the next four years beginning January 1, 2014. A final rule is expected in the fourth quarter of 2013. Subject to the terms of the final rule, the Company may be required to record asset impairments for goodwill and other intangible assets in its home health reporting unit in the fourth quarter of 2013. At September 30, 2013, goodwill associated with this business aggregated $104 million.

An impairment charge could have a material adverse effect on the Company s business, financial position and results of operations, but would not be expected to have an impact on the Company s cash flows or liquidity.

The Company s indefinite-lived intangible assets consist of trade names, Medicare certifications and certificates of need. The fair values of the Company s indefinite-lived intangible assets are derived from current market data and projections at a facility level which include management s best estimates of economic and market conditions over the projected period including growth rates in the number of admissions, patient days, reimbursement rates, operating costs, rent expense and capital expenditures. Other significant estimates and assumptions include terminal value growth rates, changes in working capital requirements and weighted average cost of capital. Certificates of need intangible assets are estimated primarily using both a replacement cost methodology and an excess earnings method, a form of discounted cash flows, which is based upon the concept that net after-tax cash flows provide a return supporting all of the assets of a business enterprise.

The loss on divestiture of the Vibra Facilities included a $21 million write-off of certain indefinite-lived intangible assets allocable to the disposed operations.

In connection with the closing of a TC hospital and a home health location, the Company recorded write-offs for certain indefinite-lived intangible assets of $4 million and $0.5 million, respectively, allocable to the ceased operations.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Critical Accounting Policies (Continued)

Valuation of long-lived assets, goodwill and intangible assets (Continued)

The annual impairment tests for certain of the Company s indefinite-lived intangible assets are performed as of May 1, July 1 and September 1 while all others are performed as of December 31. No impairment charges were recorded in connection with the annual impairment test as of September 1, 2013, July 1, 2013, May 1, 2013 or December 31, 2012. However, the impairment test at May 1, 2013 for the hospital rehabilitation services operating segment trade name indicated that the excess fair value was only 5% higher than the carrying value of $32 million. A significant assumption in determining the fair value of the trade name is revenue growth. Assuming all other assumptions remain the same, if the rate of revenue growth assumption for the hospital rehabilitation services were to be reduced by 200 basis points, an impairment charge of approximately $1 million would be required.

Recently Issued Accounting Requirements

In July 2013, the FASB issued authoritative guidance related to financial statement presentation of an unrecognized tax benefit. The main provisions of the guidance state that an entity must present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The guidance is effective for all interim and annual reporting periods beginning after December 15, 2013. Early adoption is permitted for all entities. The adoption of the guidance is not expected to have a material impact on the Company s business, financial position, results of operations or liquidity.

In February 2013, the FASB amended its authoritative guidance issued in December 2011 related to the deferral of the requirement to present reclassification adjustments out of accumulated other comprehensive income in both the statement in which net income is presented and the statement in which other comprehensive income is presented. The amended provisions require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under United States generally accepted accounting principles to be reclassified to net income in its entirety in the same reporting period. For all other amounts, an entity is required to cross-reference to other disclosures that provide additional details about these amounts. All other requirements of the original June 2011 update were not impacted by the amendment which became effective for all interim and annual reporting periods beginning after December 15, 2012. The adoption of the guidance did not have a material impact on the Company s business, financial position, results of operations or liquidity.

Results of Operations Continuing Operations

Hospital division

Revenues declined 4% to $609 million in the third quarter of 2013 compared to $637 million for the same period in 2012 and declined 3% to $1.9 billion for the nine months ended September 30, 2013 from $2.0 billion for the same period in 2012. The decline in revenue in the third quarter of 2013 and for the nine months ended September 30, 2013 was primarily a result of Medicare reimbursement reductions which began on April 1, 2013 under the Budget Control

Act of 2011 and a decline in admissions. Aggregate same-facility admissions declined 7% and 5% in the third quarter of 2013 and for the nine months ended September 30, 2013 compared to the respective prior year periods. Same-facility average daily census declined 5% and 3% in the third quarter of 2013 and for the nine months ended September 30, 2013 compared to the respective prior year periods.

Operating income for the three months ended September 30, 2013 included $5 million of costs incurred in connection with the closing of a TC hospital and a litigation charge of $0.7 million. Operating income for the nine months ended September 30, 2013 also included $8 million related to one-time bonus costs. Operating income for the nine months ended September 30, 2012 included $9 million related to severance and other costs incurred in connection with the closing of a regional office and two TC hospitals, and employment-related lawsuits. Excluding these charges, hospital operating margins decreased in the third quarter of 2013 as a result of the previously discussed reimbursement reductions and admission declines, and were relatively unchanged for the nine months ended September 30, 2013 compared to the respective prior year periods.

Average hourly wage rates declined 1% for both the third quarter of 2013 and for the nine months ended September 30, 2013 compared to the respective prior year periods. Employee benefit costs decreased 6% and 7% in the third quarter of 2013 and for the nine months ended September 30, 2013 compared to the respective prior year periods, primarily as a result of a reduction in workers compensation and compensated absences expense in the third quarter of 2013 and a reduction in workers compensation, health, retirement plan and compensated absences expense for the nine months ended September 30, 2013.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations Continuing Operations (Continued)

Hospital division (Continued)

Professional liability costs were $7 million and $9 million in the third quarter of 2013 and 2012, respectively, and $23 million and $29 million for the nine months ended September 30, 2013 and 2012, respectively. The decrease in professional liability costs was attributable to improvement in the frequency and severity of claims.

Nursing center division

Revenues declined 2% to $278 million in the third quarter of 2013 compared to $282 million in the same period in 2012 and declined 1% to $840 million for the nine months ended September 30, 2013 from $846 million for the same period in 2012. The decline in revenue for both periods was primarily a result of a decline in average daily census and to a lesser extent, Medicare reimbursement reductions which began on April 1, 2013 under the Budget Control Act of 2011. Average daily census declined 4% and 3% in the third quarter of 2013 and for the nine months ended September 30, 2013, respectively, compared to the respective prior year periods, primarily as a result of the decline in Medicare average length of stay. Admissions declined 1% in the third quarter of 2013 and were relatively unchanged for the nine months ended September 30, 2013 compared to the respective prior year periods.

Operating income for the nine months ended September 30, 2013 included $5 million related to one-time bonus costs. Operating income for the nine months ended September 30, 2012 included $1 million incurred in connection with the cancellation of a sub-acute unit project. Excluding these charges, nursing center operating margins declined in both the third quarter of 2013 and for the nine months ended September 30, 2013 compared to the respective prior year periods, primarily as a result of a decline in average daily census and related cost inefficiencies, and the previously discussed reimbursement reductions.

Average hourly wage rates increased 2% in the third quarter of 2013 and increased 1% for the nine months ended September 30, 2013 compared to the respective prior year periods. Employee benefit costs decreased 8% in both the third quarter of 2013 and for the nine months ended September 30, 2013 compared to the respective prior year periods, primarily as a result of a reduction in workers compensation and compensated absences expense in the third quarter of 2013 and a reduction in workers compensation, health and compensated absences expense for the nine months ended September 30, 2013.

Professional liability costs were $5 million and $4 million in the third quarter of 2013 and 2012, respectively, and $20 million and $11 million for the nine months ended September 30, 2013 and 2012, respectively. The increase in professional liability costs was attributable to continued deterioration in the frequency and severity of claims.

Rehabilitation division

Skilled nursing rehabilitation services

Revenues declined 3% to $244 million in the third quarter of 2013 compared to $252 million for the same period in 2012 and declined 1% at $750 million for the nine months ended September 30, 2013 compared to $759 million for the same period in 2012. Revenue decline in the third quarter of 2013 was primarily attributable to Medicare reimbursement reductions under the Taxpayer Relief Act that became effective April 1, 2013. Revenues derived from

non-affiliated customers aggregated $214 million and $224 million in the third quarter of 2013 and 2012, respectively, and $660 million and $674 million for the nine months ended September 30, 2013 and 2012, respectively.

Operating income for the three months ended September 30, 2013 included $23 million related to a litigation charge. Operating income for the nine months ended September 30, 2013 also included $5 million related to one-time bonus costs. Excluding these charges, operating margins declined in the third quarter of 2013 compared to the respective prior year period, primarily attributable to Medicare reimbursement reductions discussed above, however operating margins increased for the nine months ended September 30, 2013 compared to the respective prior year period, primarily as a result of increased operating efficiencies.

Hospital rehabilitation services

Revenues declined 5% to $68 million in the third quarter of 2013 compared to $72 million for the same period in 2012 and declined 3% to $212 million for the nine months ended September 30, 2013 from $220 million for the same period in 2012. Revenue decline in both periods was primarily attributable to contracts terminated during the nine months ended September 30, 2013. Revenues derived from non-affiliated customers aggregated $45 million and $48 million in the third quarter of 2013 and 2012, respectively, and $140 million and $146 million for the nine months ended September 30, 2013 and 2012, respectively.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations Continuing Operations (Continued)

Rehabilitation division (Continued)

Hospital rehabilitation services (Continued)

Operating margins increased in both the third quarter of 2013 and for the nine months ended September 30, 2013 compared to the respective prior year period, primarily as a result of increased operating efficiencies. Operating income for the three months ended September 30, 2013 included $0.3 million related to severance and retirement costs. Operating income for the nine months ended September 30, 2013 also included $1 million related to one-time bonus costs.

Home health and hospice division

Revenues increased 50% to $53 million in the third quarter of 2013 compared to $36 million for the same period in 2012 and increased 70% to $158 million for the nine months ended September 30, 2013 from $93 million for the same period in 2012. Revenue growth in both periods was primarily attributable to acquisitions completed during 2012 and 2013.

Operating margins declined in both the third quarter of 2013 and for the nine months ended September 30, 2013 compared to the respective prior year period, primarily due to start-up costs and the migration to standard operating systems in connection with the development of this business segment. Operating income in the third quarter of 2013 included $0.6 million of severance and retirement costs and $0.5 million of costs associated with closing a home health location. Operating income for the nine months ended September 30, 2013 also included $1 million related to one-time bonus costs.

Corporate overhead

Operating income for the Company s operating divisions excludes allocations of corporate overhead. These costs aggregated $39 million and $46 million in the third quarter of 2013 and 2012, respectively, and $128 million and $133 million for the nine months ended September 30, 2013 and 2012, respectively. The decline in corporate overhead in both periods was primarily attributable to lower incentive compensation costs. As a percentage of consolidated revenues, corporate overhead totaled 3.3% and 3.7% in the third quarter of 2013 and 2012, respectively, and totaled 3.5% and 3.6% for the nine months ended September 30, 2013 and 2012, respectively. Operating income in the third quarter of 2013 included $1 million of severance and retirement costs and $1 million of fees associated with the modification of certain of the Company s senior debt.

Transaction costs

Operating results included transaction costs totaling $1 million in the third quarter of both 2013 and 2012, and $2 million for each of the nine months ended September 30, 2013 and 2012. Transaction costs in all periods were included in other operating expenses.

Capital costs

Rent expense was relatively unchanged at $79 million in the third quarter of 2013 compared to the same period in 2012 and increased 2% to $238 million for the nine months ended September 30, 2013 from $234 million for the same period in 2012. The increase for the nine months ended September 30, 2013 resulted primarily from contractual inflation and contingent rent increases. Rent expense in the third quarter of 2012 and for the nine months ended September 30, 2012 included lease cancellation charges of $1 million and $2 million, respectively, incurred in connection with the closing of two TC hospitals.

Depreciation and amortization expense decreased 9% to $38 million in the third quarter of 2013 compared to $41 million for the same period in 2012 and decreased 1% to $120 million for the nine months ended September 30, 2013 from $121 million for the same period in 2012. The decrease in both periods resulted from an increase in assets becoming fully depreciated as compared to the same periods a year ago.

Interest expense decreased 4% to $26 million in the third quarter of 2013 compared to $27 million for the same period in 2012 and increased 4% to $83 million for the nine months ended September 30, 2013 from $80 million for the same period in 2012. The decrease in the third quarter of 2013 was primarily attributable to a reduction in both interest rates and borrowing levels. The increase for the nine months ended September 30, 2013 was primarily attributable to increased borrowings under the Term Loan Facility and $1 million of charges associated with the modification of certain of the Company s senior debt.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Results of Operations Continuing Operations (Continued)

Consolidated results

Loss from continuing operations before income taxes aggregated $29 million in the third quarter of 2013 compared to income of $12 million for the same period in 2012. Income from continuing operations before income taxes aggregated $5 million for the nine months ended September 30, 2013 compared to $55 million for the same period in 2012. Loss from continuing operations aggregated $20 million in the third quarter of 2013 compared to income of $7 million for the same period in 2012. Income from continuing operations aggregated $1 million for the nine months ended September 30, 2013 compared to $32 million for the same period in 2012. Litigation charges, costs associated with the closing of a TC hospital and a home health location, severance and retirement costs, senior debt modification charges and transaction costs negatively impacted the consolidated pretax operating results by $33 million ($23 million net of income taxes) in the third quarter of 2013. These costs as well as one-time bonus costs also negatively impacted the consolidated pretax operating results by $56 million ($37 million net of income taxes) for the nine months ended September 30, 2013. Severance costs, lease cancellation charges and other miscellaneous costs related to the closing of a regional office and two TC hospitals, the cancellation of a sub-acute unit project, employment-related lawsuits and transaction costs negatively impacted the consolidated pretax operating results by $1 million ($1 million net of income taxes) in the third quarter of 2012 and $13 million ($8 million net of income taxes) for the nine months ended September 30, 2012.

Results of Operations Discontinued Operations

Loss from discontinued operations aggregated $21 million in the third quarter of 2013 compared to income of $3 million for the same period in 2012. Loss from discontinued operations aggregated $24 million for the nine months ended September 30, 2013 compared to income of $14 million for the same period in 2012. The Company recorded a net loss of $65 million and $2 million in the third quarter of 2013 and 2012, respectively, and $78 million and $4 million for the nine months ended September 30, 2013 and 2012, respectively, related to the divestiture of discontinued operations.

On September 30, 2013, the Company entered into agreements to renew early its leases with Ventas for the Renewal Facilities and exit the 2013 Expiring Facilities. The current lease term for the Renewal Facilities and the 2013 Expiring Facilities was scheduled to expire in April 2015. Under the terms of the agreements, the lease term for the 2013 Expiring Facilities will expire on September 30, 2014. For accounting purposes, 59 of the 2013 Expiring Facilities qualified as assets held for sale and the Company reflected the operating results as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all historical periods and will reflect the facility scheduled for closure as a discontinued operation upon completion of the exit process. Under the terms of the agreements, the Company will pay $20 million to Ventas in exchange for the early termination of certain leases. The disposal group was measured at its fair value less cost to sell and the Company recorded an asset impairment charge of $8 million related to leasehold improvements in the 2013 Expiring Facilities. These charges were recorded in discontinued operations in the third quarter of 2013 in the accompanying unaudited condensed consolidated statement of operations.

The Company recorded a loss on divestiture of $76 million ($63 million net of income taxes) and $94 million ($74 million net of income taxes) during the third quarter of 2013 and for the nine months ended September 30, 2013, respectively, related to the Vibra Facilities. The loss on divestiture included a $69 million write-off of goodwill, which

was based upon the relative fair value, and a $21 million write-off of intangible assets.

The Company recorded a loss on divestiture of $2 million ($1 million net of income taxes) during the third quarter of 2013 related to the Signature Facilities.

On April 27, 2012, the Company announced that it would not renew the 2012 Expiring Facilities under operating leases with Ventas that expired on April 30, 2013. The 2012 Expiring Facilities contained 6,140 licensed nursing center beds and generated revenues of approximately $475 million for the year ended December 31, 2012. The annual rent for these facilities approximated $57 million. The Company transferred the operations of all of the 2012 Expiring Facilities to new operators during the nine months ended September 30, 2013. The Company reclassified the results of operations and losses associated with the 2012 Expiring Facilities to discontinued operations, net of income taxes, for all periods presented.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Liquidity

Operating cash flows

Cash flows provided by operations (including discontinued operations) aggregated $189 million for the nine months ended September 30, 2013 compared to $191 million for the same period in 2012. Operating cash flows for the nine months ended September 30, 2013 and September 30, 2012 included net federal income tax payments of $13 million and $5 million, respectively.

The Company utilizes its ABL Facility to meet working capital needs and finance its acquisition and development activities. As a result, the Company typically carries minimal amounts of cash on its consolidated balance sheet. Based upon the Company s expected operating cash flows and the availability of borrowings under the Company s ABL Facility ($587 million at September 30, 2013), management believes that the Company has the necessary financial resources to satisfy its expected short-term and long-term liquidity needs.

Dividend declaration

The Company s Board of Directors approved a quarterly cash dividend to its shareholders of $0.12 per common share (approximately $6 million) that was paid on September 9, 2013 to shareholders of record as of the close of business on August 19, 2013. On November 5, 2013, the Company announced that its Board of Directors approved the payment of a quarterly cash dividend to its shareholders of $0.12 per common share to be paid on December 9, 2013 to shareholders of record as of the close of business on November 18, 2013. Future declarations of quarterly dividends will be subject to the approval of Kindred s Board of Directors. The cash dividend funding will require the use of approximately $6 million in the fourth quarter of 2013 and would require approximately $26 million on an annual basis.

Credit facilities and notes

In connection with the RehabCare Merger, the Company entered into the Credit Facilities and issued the Notes. In 2011, the Company used proceeds from the Credit Facilities and the Notes to pay the Merger Consideration, repay all amounts outstanding under the Company s and RehabCare s previous credit facilities and to pay transaction costs. The amounts outstanding under the Company s and RehabCare s former credit facilities that were repaid at the RehabCare Merger closing were $390 million and $345 million, respectively.

In August 2013, the Company completed amendments and restatements to the Credit Facilities to increase its borrowing capacity and improve its financial flexibility. The amendments include, among other things, the following changes: (a) refreshing the option to increase the credit capacity in the aggregate between the Credit Facilities by $250 million; (b) establishing the option to further increase the credit capacity between the Credit Facilities upon satisfaction of a secured leverage ratio; (c) extending the maturity of the ABL Facility by two years to June 2018; (d) eliminating the annual and cumulative limitations on acquisitions; (e) raising to $150 million the Company s ability to pay cash dividends, buy back stock and make other restricted payments; and (f) easing the restrictions on the Company s ability to make investments and enter into other joint venture arrangements. The interest rate pricing levels were not changed in connection with the amendments.

In May 2013, the Company completed an amendment and restatement of its Term Loan Facility to reduce its annual interest cost by 100 basis points. The applicable interest rate on the Term Loan Facility, which matures on June 1, 2018, was reduced by 50 basis points to LIBOR plus 325 basis points (previously LIBOR plus 375 basis points). In addition, the LIBOR floor was reduced to 1.00% from 1.50%. The Company expects that these changes will result in annualized interest savings of approximately $8 million.

The Company recorded fees associated with the amendments of $0.5 million during the three months ended September 30, 2013, which are included in other operating expenses in the accompanying unaudited condensed consolidated statement of operations. The Company also recorded charges associated with the amendments and restatements of $0.1 million and $1.5 million during the three and nine months ended September 30, 2013, respectively, which are included in interest expense in the accompanying unaudited condensed consolidated statement of operations.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Liquidity (Continued)

Credit facilities and notes (Continued)

The Credit Facilities previously had an incremental facility capacity in an aggregate amount between the two facilities of $200 million. In October 2012, the Company executed the incremental capacity by completing modifications to increase by $100 million its Term Loan Facility and expand by $100 million the borrowing capacity under its ABL Facility. The additional Term Loan Facility borrowings were issued at 97.5% and the net proceeds were used to pay down a portion of the outstanding balance under the ABL Facility. The aggregate amount outstanding under the Term Loan Facility at September 30, 2013 approximated $786 million. In connection with the $100 million expansion of the borrowing capacity under its ABL Facility, the Company also modified the accounts receivable borrowing base which will allow the Company to more easily access the full amount of the available credit. The other terms of the Term Loan Facility and the ABL Facility were unchanged.

All obligations under the Credit Facilities are fully and unconditionally guaranteed, subject to certain customary release provisions, by substantially all of the Company s existing and future direct and indirect domestic 100% owned subsidiaries, as well as certain non-100% owned domestic subsidiaries as the Company may determine from time to time in its sole discretion. The Notes are fully and unconditionally guaranteed, subject to certain customary release provisions, by substantially all of the Company s domestic 100% owned subsidiaries.

The agreements governing the Credit Facilities and the indenture governing the Notes include a number of restrictive covenants that, among other things and subject to certain exceptions and baskets, impose operating and financial restrictions on the Company and certain of its subsidiaries. The Company s ability to pay dividends is limited to certain restricted payment baskets, which may expand based upon accumulated earnings. In addition, the Company is required to comply with a minimum fixed charge coverage ratio and a maximum total leverage ratio under the Credit Facilities. The financing agreements governing the Credit Facilities and the indenture governing the Notes also contain customary affirmative covenants and events of default. The Company was in compliance with the terms of the Credit Facilities and the indenture governing the Notes at September 30, 2013.

Interest rate swaps

In December 2011, the Company entered into two interest rate swap agreements to hedge its floating interest rate on an aggregate of $225 million of debt outstanding under its Term Loan Facility. The interest rate swaps have an effective date of January 9, 2012, and expire on January 11, 2016. The Company is required to make payments based upon a fixed interest rate of 1.8925% calculated on the notional amount of $225 million. In exchange, the Company will receive interest on $225 million at a variable interest rate that is based upon the three-month LIBOR, subject to a minimum rate of 1.5%. The Company determined the interest rate swaps continue to qualify for cash flow hedge accounting treatment at September 30, 2013. However, the Term Loan Facility amendment completed in May 2013 reduced the LIBOR floor from 1.5% to 1.0%, therefore some partial ineffectiveness will result through the expiration of the interest rate swap agreement. For the three and nine months ended September 30, 2013, there was $0.1 million and $0.4 million, respectively, of ineffectiveness recognized related to the interest rate swaps recorded in interest expense. The fair value of the interest rate swaps recorded in other accrued liabilities was $2 million and $3 million at September 30, 2013 and December 31, 2012, respectively.

Other financing activities

As a result of deterioration in professional liability and workers compensation underwriting results of the Company s limited purpose insurance subsidiary in 2012 and 2011, the Company made capital contributions of $14 million and $9 million during the nine months ended September 30, 2013 and 2012, respectively, to its limited purpose insurance subsidiary. These transactions were completed in accordance with applicable regulations. Neither capital contribution had any impact on earnings.

Divestiture of facilities

During the third quarter of 2013, the Company completed the sale of the Vibra Facilities for $187 million to an affiliate of Vibra. The net proceeds of $180 million from this transaction were used to reduce the Company s borrowings under its ABL Facility.

On July 31, 2013, the Company completed the sale of the Signature Facilities for $47 million to affiliates of Signature. The proceeds from the transaction were used to reduce the Company s borrowings under its ABL Facility.

The Company received cash proceeds of $13 million for the nine months ended September 30, 2013 for the sale of property and equipment and inventory related to the 2012 Expiring Facilities.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Capital Resources

Capital expenditures and acquisitions

Excluding acquisitions, routine capital expenditures (expenditures necessary to maintain existing facilities that generally do not increase capacity or add services) totaled $63 million for the nine months ended September 30, 2013 compared to $77 million for the same period in 2012. Hospital development capital expenditures (primarily new and replacement facility construction) totaled $11 million for the nine months ended September 30, 2013 compared to $35 million for the same period in 2012. Nursing center development capital expenditures (primarily the addition of transitional care services for higher acuity patients) were immaterial for the nine months ended September 30, 2013 and totaled $3 million for the same period in 2012. Excluding acquisitions, the Company anticipates that routine capital spending for 2013 should approximate $105 million to $115 million and development capital spending should approximate $12 million. Management expects that substantially all of these expenditures will be financed through internal sources. Management believes that its capital expenditure program is adequate to improve and equip existing facilities. At September 30, 2013, the estimated cost to complete and equip construction in progress approximated $11 million.

Acquisition expenditures totaled $39 million for the nine months ended September 30, 2013 compared to $139 million for the same period in 2012. Acquisition deposits totaled $15 million in the third quarter of 2013, primarily related to the purchase of a hospital rehabilitation services company. The Company financed these acquisitions with its operating cash flows and its ABL Facility.

On November 4, 2013, the Company announced that it has signed a definitive agreement to acquire Senior Home Care for a purchase price of $95 million. The Company expects to finance the transaction with operating cash flows and proceeds from its ABL Facility. The transaction with Senior Home Care is subject to several regulatory approvals and other customary conditions to closing. The Company expects to close the transaction in the fourth quarter of 2013.

On November 5, 2013, the Company announced that its subsidiary has signed a definitive agreement with HCP to acquire the real estate associated with nine nursing centers that it currently leases from HCP for approximately $83 million. The annual lease payments for these nursing centers are approximately $9 million. The transaction with HCP is subject to several conditions to closing. The Company expects to close the transaction in the fourth quarter of 2013.

Renewal of Ventas facilities

On September 30, 2013, the Company entered into agreements to renew early its leases with Ventas for the Renewal Facilities. The current lease term for the Renewal Facilities was scheduled to expire in April 2015.

The Company will renew the existing leases for three TC hospitals and 15 nursing centers for an additional five year term effective May 1, 2015. The annual rents for these facilities will increase by $4 million on October 1, 2014 and are subject to various rent escalators contained within the existing master leases. In addition, the Company will renew the leases for 19 TC hospitals and 11 nursing centers for a term of 10 years and seven months effective October 1, 2014. The annual rents for these facilities will increase by $11 million on October 1, 2014 and are subject to annual increases based upon the change in the consumer price index (subject to an annual 4% cap). For accounting purposes, the Company will record the additional rents over the new lease term on a straight-line basis beginning on October 1, 2013, the effective date of the agreements.

The current aggregate annual rent for the Renewal Facilities approximates $79 million. The 22 TC hospitals contain 1,753 licensed beds and generated revenues and segment operating income (excluding the allocation of approximately $17 million of overhead costs) of approximately $572 million and $115 million, respectively, for the year ended December 31, 2012. The 26 nursing centers contain 3,134 licensed beds and generated revenues and segment operating income (excluding the allocation of approximately $8 million of overhead costs) of approximately $271 million and $56 million, respectively, for the year ended December 31, 2012. The terms of the new leases are substantially similar to the terms of the existing master lease agreements between the Company and Ventas.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Information

Effects of inflation and changing prices

The Company derives a substantial portion of its revenues from the Medicare and Medicaid programs. Congress and certain state legislatures have enacted or may enact additional significant cost containment measures limiting the Company s ability to recover its cost increases through increased pricing of its healthcare services. Medicare revenues in TC hospitals and nursing centers are subject to fixed payments under the Medicare prospective payment systems.

Medicaid reimbursement rates in many states in which the Company operates nursing centers also are based upon fixed payment systems. Generally, these rates are adjusted annually for inflation. However, these adjustments may not reflect the actual increase in the costs of providing healthcare services.

Various healthcare reform provisions became law upon the enactment of the ACA. The reforms contained in the ACA have affected each of the Company s businesses in some manner and are directed in large part at increased quality and cost reductions. Several of the reforms are very significant and could ultimately change the nature of the Company s services, the methods of payment for the Company s services and the underlying regulatory environment. These reforms include possible modifications to the conditions of qualification for payment, bundling of payments to cover both acute and post-acute care and the imposition of enrollment limitations on new providers.

The ACA also provides for: (1) reductions to the annual market basket payment updates for LTAC hospitals, IRFs, home health agencies and hospice providers which could result in lower reimbursement than in the preceding year; (2) additional annual productivity adjustment reductions to the annual market basket payment update as determined by CMS for LTAC hospitals, IRFs, and nursing centers (beginning in federal fiscal year 2012), home health agencies (beginning in federal fiscal year 2015) and hospice providers (beginning in federal fiscal year 2013); (3) new transparency, reporting and certification requirements for skilled nursing facilities, including disclosures regarding organizational structure, officers, directors, trustees, managing employees and financial, clinical and other related data; (4) a quality reporting system for hospitals (including LTAC hospitals and IRFs) beginning in federal fiscal year 2014; and (5) reductions in Medicare payments to hospitals (including LTAC hospitals and IRFs) beginning in federal fiscal year 2014 for failure to meet certain quality reporting standards or to comply with standards in new value based purchasing demonstration project programs.

The healthcare reforms and changes resulting from the ACA, as well as other similar healthcare reforms, could have a material adverse effect on the Company s business, financial position, results of operations and liquidity.

Under the Budget Control Act of 2011, $1.2 trillion in domestic and defense spending reductions automatically began February 1, 2013, split evenly between domestic and defense spending. Payments to Medicare providers are subject to these automatic spending reductions, subject to a 2% cap. As discussed below, the Taxpayer Relief Act subsequently delayed by two months the automatic budget sequestration cuts established by the Budget Control Act of 2011. The automatic 2% reduction on each claim submitted to Medicare began on April 1, 2013. Reductions to Medicare and Medicaid reimbursement resulting from the Budget Control Act of 2011 could have a material adverse effect on the Company s business, financial position, results of operations and liquidity.

The Taxpayer Relief Act was enacted on January 2, 2013. As noted above, this Act delayed by two months the automatic budget sequestration cuts established by the Budget Control Act of 2011. The Taxpayer Relief Act also:

(1) reduces Medicare payments by 50% for subsequent procedures when multiple therapy services are provided on the same day; (2) extends the Medicare Part B outpatient therapy cap exception process to December 31, 2013; (3) suspends until December 31, 2013 the sustainable growth rate adjustment (SGR) reduction applicable to the Medicare Physician Fee Schedule (MPFS) for certain services provided under Medicare Part B; (4) increases the statute of limitations to recover Medicare overpayments from three years to five years; and (5) creates a new federal Commission on Long-Term Care to provide recommendations on the establishment, implementation and financing of a comprehensive, coordinated and high-quality system that ensures the availability of long-term care services. The Company believes that the new rules related to multiple therapy services will reduce its Medicare revenues by $25 million to $30 million on an annual basis.

The Company believes that its operating margins will continue to be under pressure as the growth in operating expenses, particularly professional liability, labor and employee benefits costs, exceeds payment increases from Medicare, Medicaid and third party payors. In addition, as a result of competitive pressures, the Company s ability to maintain operating margins through price increases to private patients is limited.

For additional information regarding Medicare and Medicaid reimbursement and other government regulations impacting the Company, see the Company s Annual Report on Form 10-K for 2012 as filed with the SEC.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Information (Continued)

Effects of inflation and changing prices (Continued)

Hospital division

The Long-Term Acute Care Prospective Payment System (LTAC PPS) maintains LTAC hospitals as a distinct provider type, separate from short-term acute care hospitals. Only providers certified as LTAC hospitals may be paid under this system. All of the Company s TC hospitals are certified as LTAC hospitals. To maintain certification under LTAC PPS, the average length of stay of fee-for-service Medicare patients must be greater than 25 days. Medicare Advantage patients are included with Medicare fee-for-service patients in order to determine compliance with the 25-day average length of stay requirement.

CMS has, for a number of years, considered the development of facility and patient certification criteria for LTAC hospitals, potentially as an alternative to the current 25-day length of stay certification system. In 2004, the Medicare Payment Advisory Commission, a commission chartered by Congress to advise it on Medicare payment issues (MedPAC), recommended the adoption by CMS of new facility staffing and services criteria and patient clinical characteristics and treatment requirements for LTAC hospitals in order to ensure that only appropriate patients are admitted to these facilities. Since the MedPAC recommendation, CMS has initiated studies to examine such recommendations and those studies are ongoing. Implementation of additional criteria that may limit the population of patients eligible for the Company s hospital services or change the basis on which the Company is paid could have a material adverse effect on the Company s business, financial position, results of operations and liquidity.

On August 2, 2013, CMS issued final regulations regarding Medicare reimbursement for LTAC hospitals for the federal fiscal year beginning October 1, 2013. Included in the final regulations are: (1) a market basket increase to the standard federal payment rate of 2.5%; (2) offsets to the standard federal payment rate mandated by the ACA of: (a) 0.5% to account for the effect of a productivity adjustment, and (b) 0.3% as required by statute; (3) a wage level budget neutrality factor of 1.0010531 applied to the adjusted standard federal payment rate; (4) adjustments to area wage indexes; and (5) a decrease in the high cost outlier threshold per discharge to $13,314. In addition, the final regulations also would implement the second year of a three-year phase-in of a 3.75% budget neutrality adjustment which would reduce LTAC hospital rates by 1.3% in 2014. CMS has projected the impact of these changes will result in a 1.3% increase to average Medicare payments to LTAC hospitals. These final regulations also allow for the expiration of the existing moratorium on the 25 Percent Rule, which dictates that LTAC hospitals are to be paid under LTAC PPS for admissions from a single referral source up to 25% of aggregate Medicare admissions. Admissions beyond the 25% threshold are to be paid at a lower amount based upon the Medicare prospective payment system applicable to general short-term acute care hospitals (IPPS). CMS has indicated that the impact of the expiration of the 25 Percent Rule will result in approximately a 1.6% reduction in payments to LTAC hospitals.

In addition, CMS published preliminary findings regarding patient and facility-level criteria for LTAC hospitals, with proposed specific recommendations expected in the spring of 2014 which could potentially be implemented in the federal fiscal year beginning October 1, 2014. CMS is considering payment options that would limit the full payment under LTAC PPS to patients that are defined as chronically critically ill (CCI). CMS s research suggests that CCI patients be defined as having at least one of five medically complex conditions combined with a stay of at least eight days in an intensive care or cardiac care unit in a general short-term acute care hospital. For those patients not meeting the CCI criteria, CMS suggests that payments could be made to the LTAC hospital at an amount comparable to what a

general short-term hospital would receive under IPPS.

On August 1, 2012, CMS issued the 2012 CMS Rules, which, among other things, will reduce Medicare reimbursement to the Company s TC hospitals in 2013 and beyond by imposing a budget neutrality adjustment and modifying the short-stay outlier rules. Included in the 2012 CMS Rules are: (1) a market basket increase to the standard federal payment rate of 2.6%; (2) offsets to the standard federal payment rate mandated by the ACA of: (a) 0.7% to account for the effect of a productivity adjustment, and (b) 0.1% as required by statute; (3) a wage level budget neutrality factor of 0.999265 applied to the adjusted standard federal payment rate; (4) adjustments to area wage indexes; and (5) a decrease in the high cost outlier threshold per discharge to $15,408. Effective December 29, 2012, the 2012 CMS Rules (1) began a three-year phase-in of a 3.75% budget neutrality adjustment which will reduce LTAC hospital rates by 1.3% in 2013; and (2) restored a payment reduction that will limit payments for very short-stay outliers that will reduce the Company s TC hospital payments by approximately 0.5%. The 2012 CMS Rules also (1) provide for a one-year extension of the existing moratorium on the 25 Percent Rule, and (2) allow for the expiration of the moratorium on the development or expansion of LTAC hospitals on December 29, 2012.

In aggregate, based upon its review of the 2012 CMS Rules, the Company expects that LTAC Medicare payment rates will decline slightly in 2013. The 2012 CMS Rules do not include the impact of a 2% sequestration payment reduction mandated by Congress that applies to each claim submitted to Medicare that began on April 1, 2013.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Information (Continued)

Effects of inflation and changing prices (Continued)

Hospital division (Continued)

On August 1, 2011, CMS issued final regulations regarding Medicare reimbursement for LTAC hospitals for the fiscal year beginning October 1, 2011. Included in the final regulations is: (1) a market basket increase to the standard federal payment rate of 2.9%; (2) offsets to the standard federal payment rate mandated by the ACA of: (a) 1.0% to account for the effect of a productivity adjustment, and (b) 0.1% as required by statute; (3) a wage level budget neutrality factor of 0.99775 applied to the adjusted standard federal payment rate; (4) adjustments to area wage indexes; and (5) a decrease in the high cost outlier threshold per discharge to $17,931. CMS has projected the impact of these changes will result in a 2.5% increase to average Medicare payments to LTAC hospitals. Management believes that the impact of these changes to LTAC PPS resulted in an approximate 0.7% increase in payments to the Company s TC hospitals.

On December 29, 2007, the SCHIP Extension Act of 2007 (the SCHIP Extension Act) became law. This legislation provided for, among other things: (1) a mandated study by the Secretary of Health and Human Services on the establishment of LTAC hospital certification criteria; (2) enhanced medical necessity review of LTAC hospital cases; (3) a three-year moratorium on the establishment of new LTAC hospital or satellite facilities and increases in the number of licensed beds at a LTAC hospital or satellite facility; (4) a three-year moratorium on the application of a one-time budget neutrality adjustment to payment rates to LTAC hospitals under LTAC PPS; (5) a three-year moratorium on very short-stay outlier payment reductions to LTAC hospitals initially implemented on May 1, 2007; and (6) a three-year moratorium on the application of the 25 Percent Rule to freestanding LTAC hospitals.

The ACA extended the moratoriums on the establishment of new LTAC hospitals or satellites and bed increases at LTAC hospitals or satellites, the application of a one-time budget neutrality adjustment to rates, and the payment reductions due to the very short-stay outlier provisions from three years to five years. These moratoriums expired on December 29, 2012. As discussed above, the 2012 CMS Rules began a three-year phase-in of a 3.75% budget neutrality adjustment which will reduce LTAC hospital rates by 1.3% in 2013.

The ACA also extended the moratorium on the expansion of the 25 Percent Rule to freestanding LTAC hospitals from three years to five years. Following the ACA, the moratorium on the expansion of the 25 Percent Rule to freestanding LTAC hospitals was set to expire for cost reporting periods beginning on or after July 1, 2012. However, the 2012 CMS Rules further extended the moratorium to all freestanding LTAC hospitals with cost reporting periods beginning on or after October 1, 2012 and before October 1, 2013.

CMS has regulations governing payments to LTAC hospitals that are co-located with another hospital (a HIH). The rules generally limit Medicare payments to the HIH if the Medicare admissions to the HIH from its co-located hospital exceed 25% of the total Medicare discharges for the HIH s cost reporting period, the 25 Percent Rule. There are limited exceptions for admissions from rural, urban single or a hospital that generates more than 25% of the Medicare discharges in a metropolitan statistical area (MSA Dominant hospital). Admissions that exceed this 25 Percent Rule are paid a lower amount under IPPS. Patients transferred after they have reached the short-term acute care outlier payment status are not counted toward the admission threshold. Patients admitted prior to meeting the admission threshold, as well as Medicare patients admitted from a non co-located hospital, are eligible for the full payment under

LTAC PPS. If the HIH s admissions from the co-located hospital exceed the limit in a cost reporting period, Medicare will pay the lesser of: (1) the amount payable under LTAC PPS; or (2) the amount payable under IPPS. At September 30, 2013, the Company operated 22 HIHs with 835 licensed beds.

On May 1, 2007, CMS issued regulatory changes regarding Medicare reimbursement for LTAC hospitals (the 2007 Final Rule). In the 2007 Final Rule, the 25 Percent Rule was expanded to all LTAC hospitals, regardless of whether they are co-located with another hospital. Under the 2007 Final Rule, all LTAC hospitals were to be paid LTAC PPS rates for admissions from a single referral source up to 25% of aggregate Medicare admissions. Patients reaching high cost outlier status in the short-term hospital were not to be counted when computing the 25% limit. Admissions beyond the 25% threshold were to be paid at a lower amount based upon IPPS rates. However, as set forth above, the SCHIP Extension Act initially placed a three-year moratorium on the expansion of the 25 Percent Rule to freestanding hospitals. That moratorium was extended to five years by the ACA. This moratorium was further extended for one additional year under the 2012 CMS Rules. In addition, the SCHIP Extension Act initially provided for a three-year period during which: (1) LTAC hospitals may admit up to 50% of their patients from their co-located hospitals and still be paid according to LTAC PPS; and (2) LTAC hospitals that are co-located with an urban single hospital or a MSA Dominant hospital may admit up to 75% of their patients from such urban single hospital or MSA Dominant hospital and still be paid according to LTAC PPS. Those periods also were extended to five years under the ACA and for one additional year under the 2012 CMS Rules. The final LTAC hospital rule issued on August 2, 2013 will allow the moratorium to expire for providers with cost reporting periods beginning on or after October 1, 2013.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Information (Continued)

Effects of inflation and changing prices (Continued)

Hospital division (Continued)

The ACA requires a quality reporting system for LTAC hospitals beginning in federal fiscal year 2014 under which any market basket update would be reduced by 2% for any LTAC hospital that does not meet the quality reporting standards. CMS has issued final regulations that require LTACs to report quality measures related to, among other items, catheter-associated urinary tract infections, central line associated blood stream infections, new or worsening pressure ulcers, unplanned readmissions and falls with major injury.

The Job Creation Act of 2012 (the Job Creation Act) provides for reductions in reimbursement of Medicare bad debts at the Company s hospitals and nursing centers. For the hospitals, the current bad debt reimbursement rate of 70% for all bad debts will be lowered to 65% effective for cost reporting periods beginning on or after October 1, 2012.

The Company cannot predict the ultimate long-term impact of LTAC PPS. This payment system is subject to significant change. Slight variations in patient acuity or length of stay could significantly change Medicare revenues generated under LTAC PPS. In addition, the Company s TC hospitals may not be able to appropriately adjust their operating costs to changes in patient acuity and length of stay or to changes in reimbursement rates. In addition, there can be no assurance that LTAC PPS will not have a material adverse effect on revenues from commercial third party payors. Various factors, including a reduction in average length of stay, have negatively impacted revenues from commercial third party payors in recent years.

On July 31, 2013, CMS issued final regulations regarding Medicare reimbursement for IRFs for the fiscal year beginning October 1, 2013. Included in these final regulations are: (1) a market basket increase to the standard payment conversion factor of 2.6%; (2) offsets to the standard payment conversion factor mandated by the ACA of: (a) 0.5% to account for the effect of a productivity adjustment, and (b) 0.3% as required by statute; (3) adjustments to area wage indexes; and (4) a decrease in the high cost outlier threshold per discharge to $9,272. CMS has projected the impact of these changes will result in a 2.3% increase to average Medicare payments to IRFs.

On July 25, 2012, CMS issued final regulations regarding Medicare reimbursement for IRFs for the fiscal year beginning October 1, 2012. Included in these final regulations are: (1) a market basket increase to the standard payment conversion factor of 2.7%; (2) offsets to the standard payment conversion factor mandated by the ACA of: (a) 0.7% to account for the effect of a productivity adjustment, and (b) 0.1% as required by statute; (3) adjustments to area wage indexes; and (4) a decrease in the high cost outlier threshold per discharge to $10,466. CMS has projected the impact of these changes will result in a 2.1% increase to average Medicare payments to IRFs.

On July 29, 2011, CMS issued final regulations regarding Medicare reimbursement for IRFs for the fiscal year beginning October 1, 2011. Included in these final regulations are: (1) a market basket increase to the standard payment conversion factor of 2.9%; (2) offsets to the standard payment conversion factor mandated by the ACA of: (a) 1.0% to account for the effect of a productivity adjustment, and (b) 0.1% as required by statute; (3) a wage level budget neutrality factor of 0.9988 applied to the standard payment conversion factor; (4) a case mix group budget neutrality factor of 0.9988 applied to the standard payment conversion factor; (5) adjustments to area wage indexes; and (6) a decrease in the high cost outlier threshold per discharge to $10,660.

Similar to LTAC hospitals, the ACA requires a quality reporting system for IRFs beginning in fiscal year 2014 in which any market basket update would be reduced by 2% for any IRF that does not meet quality reporting standards. CMS has finalized regulations that require IRFs to report quality measures related to, among other items, catheter-associated urinary tract infections, pressure ulcers and unplanned readmissions.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Information (Continued)

Effects of inflation and changing prices (Continued)

Nursing center division

On July 16, 2010, CMS issued a notice that updated the payment rates for nursing centers for the fiscal year beginning October 1, 2010. Under this rule, for the fiscal year beginning October 1, 2010, CMS increased the number of resource utilization group (RUG) categories for nursing centers from 53 to 66 (i.e., RUGs IV) and amended the criteria, including the provision of therapy services, used to classify patients into these categories. CMS began paying claims using the RUGs IV system effective October 1, 2010. Under RUGs IV, among other requirements, providers must allocate therapy minutes among the patients being served during concurrent therapy sessions, and a therapist/assistant may treat concurrently only two patients. These changes have required the Company to employ more therapists to provide additional individual therapy minutes.

The therapy time requirements to qualify for rehabilitation RUG categories are unchanged under RUGs IV, however the regulatory changes altered how minutes were allocated to calculate the RUGs scores using the most recent clinical assessment tool of the minimum data set, MDS 3.0. Rather than count all therapy time that a nursing center patient receives, rehabilitation providers must instead allocate therapy minutes between the patients being served during concurrent therapy sessions. In addition, the number of patients that a therapist/assistant may treat concurrently is limited to two patients. Under final rules issued by CMS in 2011, group therapy is defined as therapy sessions with four patients who are performing similar therapy activities. Irrespective of the number of patients ultimately treated in a group therapy session, rehabilitation providers must allocate therapy minutes during such sessions as if four patients are being served. The Company s rehabilitation division hired additional therapists to facilitate the provision of additional individual minutes to address patient needs.

On July 31, 2013, CMS issued final regulations updating Medicare payment rates for skilled nursing centers effective October 1, 2013. These final regulations implement a net market basket increase of 1.3% consisting of: (1) a 2.3% market basket inflation increase, less (2) a 0.5% adjustment to account for the effect of a productivity adjustment, and less (3) a 0.5% market basket forecast error adjustment.

On July 27, 2012, CMS issued final regulations updating Medicare payment rates for skilled nursing centers effective October 1, 2012. These final regulations implement a net market basket increase of 1.8% consisting of: (1) a 2.5% market basket inflation increase, less (2) a 0.7% adjustment to account for the effect of a productivity adjustment.

On July 29, 2011, CMS issued the 2011 CMS Rules which, among other things, impose: (1) a negative adjustment to RUGs IV therapy rates, and (2) a net market basket increase of 1.7% consisting of (a) a 2.7% market basket inflation increase, less (b) a 1.0% adjustment to account for the effect of a productivity adjustment, beginning on October 1, 2011. CMS projected the impact of these changes will result in an 11.1% decrease in payments to skilled nursing centers. In addition to these rate changes, the 2011 CMS Rules introduced additional changes to RUG calculations along with adding additional patient assessments. Under the 2011 CMS Rules, group therapy is defined as therapy sessions with four patients who are performing similar therapy activities. In addition, for purposes of assigning patients to RUGs IV payment categories, the minutes of group therapy are divided by four with 25% of the minutes being allocated to each patient. The 2011 CMS Rules also clarify the circumstances for reporting breaks in care of three or more days of therapy and also implement a new change of therapy assessment that is designed to allocate the

patient to the RUG level that represents the treatment provided in the last seven days. Both changes are likely to produce alterations in the RUG scores billed for the patient along with generating additional patient assessments. The Company believes that the 2011 CMS Rules on an annual basis have reduced its revenues by approximately $100 million to $110 million in the Company s nursing center business and have negatively impacted the Company s rehabilitation therapy business by approximately $40 million to $50 million.

In February 2012, Congress passed the Job Creation Act which provides for reductions in reimbursement of Medicare bad debts at the Company s nursing centers. The Job Creation Act provides for a phase-in of the reduction in the rate of reimbursement for bad debts of patients that are dually eligible for Medicare and Medicaid. The rate of reimbursement for bad debts for these dually eligible patients will be reduced from 100% to 88%, then 76% and then 65% for cost reporting periods beginning on or after October 1, 2012, October 1, 2013, and October 1, 2014, respectively. The rate of reimbursement for bad debts for patients not dually eligible for both Medicare and Medicaid was reduced from 70% to 65%, for cost reporting periods beginning on or after October 1, 2012. Approximately 90% of the Company s Medicare bad debt reimbursements are associated with patients that are dually eligible.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Information (Continued)

Effects of inflation and changing prices (Continued)

Rehabilitation division

Medicare Part B provides reimbursement for certain physician services, limited drug coverage and other outpatient services, such as therapy and other services, outside of a Medicare Part A covered patient stay. Payment for these services is determined according to the MPFS. Annually since 1997, the MPFS has been subject to the SGR, which is intended to keep spending growth in line with allowable spending. Each year since the SGR was enacted, this adjustment produced a scheduled negative update to payment for physicians, therapists and other healthcare providers paid under the MPFS. Annually, since 2002, Congress has stepped in with so-called doc fix legislation to suspend payment cuts to physicians. Various legislation has annually suspended the payment cut. The Taxpayer Relief Act further suspended the payment cut until December 31, 2013.

Effective January 1, 2011, reimbursement rates for Medicare Part B therapy services included in the MPFS were reduced by 25% for subsequent procedures when multiple therapy services are provided on the same day. The Taxpayer Relief Act will further reduce Medicare payments for subsequent procedures when multiple therapy services are provided on the same day. The Company believes that the rules related to multiple therapy services will reduce its revenues by $25 million to $30 million on an annual basis.

Since 2006, federal legislation has provided for an annual Medicare Part B outpatient therapy cap. In succeeding years, CMS increased the amount of the therapy cap. Legislation also was passed that required CMS to implement a broad process for reviewing medically necessary therapy claims, creating an exception to the cap. Legislation has annually extended the Medicare Part B outpatient therapy cap exception process. The Job Creation Act extended the therapy cap exception process through December 31, 2012. The Taxpayer Relief Act further extended the therapy cap exception process through December 31, 2013. Patients in the Company s facilities whose stay is not reimbursed by Medicare Part A must seek reimbursement for their therapy under Medicare Part B and are subject to the therapy cap.

In February 2012, the Middle Class Tax Relief Act of 2012 was enacted, which provides that certain Medicare Part B therapy services exceeding a threshold of $3,700 would be subject to a pre-payment manual medical review process effective October 1, 2012. The review process for these services was scheduled to expire on December 31, 2012 but was extended through December 31, 2013 under the Taxpayer Relief Act. This review process has had an adverse effect on the provision and billing of services for patients and could negatively impact therapist efficiencies.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Other Information (Continued)

Effects of inflation and changing prices (Continued)

Home health and hospice division

On July 3, 2013, CMS issued proposed regulations regarding Medicare payment rates for home health agencies effective January 1, 2014. These proposed regulations implement a market basket increase of 2.4%. As mandated by the ACA, CMS proposed to rebase home health payment rates by reducing the national standardized 60 day episode payment rate by 3.5% in each of the next four years beginning January 1, 2014. Rebasing adjustments also included increases in the national per visit payment rates for low utilization episodes and a decrease in the non-routine medical supply conversion factor. In addition, CMS proposed the removal of two categories of diagnostic codes from the Home Health Prospective Payment System Grouper. CMS has projected the impact of these changes will result in a 1.5% decrease in payments to home health agencies in calendar year 2014.

On August 2, 2013, CMS issued final regulations regarding Medicare payment rates for hospice providers effective October 1, 2013. These final regulations implement a net market basket increase of 1.7% consisting of: (1) a 2.5% market basket inflation increase, less (2) offsets to the standard payment conversion factor mandated by the ACA of: (a) a 0.5% adjustment to account for the effect of a productivity adjustment, and (b) 0.3% as required by statute. In addition, CMS continued the phase-out of the wage index budget neutrality adjustment. CMS has projected the impact of these changes will result in a 1.0% increase in payments to hospice providers.

On November 2, 2012, CMS issued final regulations regarding Medicare payment rates for home health agencies effective January 1, 2013. These final regulations implement a net market basket increase of 1.3% consisting of: (1) a 2.3% market basket inflation increase, less (2) a 1.0% adjustment mandated by the ACA. In addition, CMS implemented a 1.32% reduction in case mix. CMS has projected the impact of these changes will result in a 0.01% decrease in payments to home health agencies.

On July 24, 2012, CMS issued final regulations regarding Medicare payment rates for hospice providers effective October 1, 2012. These final regulations implement a net market basket increase of 1.6% consisting of: (1) a 2.6% market basket inflation increase, less (2) offsets to the standard payment conversion factor mandated by the ACA of: (a) a 0.7% adjustment to account for the effect of a productivity adjustment, and (b) 0.3% as required by statute. In addition, CMS continued the phase-out of the wage index budget neutrality adjustment. CMS has projected the impact of these changes will result in a 0.9% increase in payments to hospice providers.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Condensed Consolidated Statement of Operations

(Unaudited)

(In thousands, except per share amounts)

	2012 Quarters				2013 Quarters		
	First	Second	Third	Fourth	First	Second	Third
Revenues	$ 1,269,884	$ 1,229,108	$ 1,226,159	$ 1,247,549	$ 1,288,867	$ 1,218,116	$ 1,198,473
Salaries, wages and benefits	780,050	747,992	754,761	761,494	799,519	731,401	733,605
Supplies	89,805	86,652	85,129	85,535	86,835	83,025	81,812
Rent	76,947	78,186	79,312	79,047	78,982	79,864	79,269
Other operating expenses	233,198	236,418	230,076	227,873	239,402	236,227	269,927
Other (income) expense	(3,136)	(3,165)	(3,178)	(3,181)	(1,009)	(26)	52
Impairment charges	498	111	406	108,127	187	457	441
Depreciation and amortization	39,470	40,655	41,304	42,623	42,650	39,631	37,591
Interest expense	26,570	26,713	26,663	27,929	28,171	29,084	25,633
Investment income	(283)	(258)	(212)	(246)	(88)	(1,475)	(1,235)
	1,243,119	1,213,304	1,214,261	1,329,201	1,274,649	1,198,188	1,227,095
Income (loss) from continuing operations before income taxes	26,765	15,804	11,898	(81,652)	14,218	19,928	(28,622)
Provision (benefit) for income taxes	11,039	6,817	5,070	2,870	5,264	8,027	(9,003)
Income (loss) from continuing	15,726	8,987	6,828	(84,522)	8,954	11,901	(19,619)

operations							
Discontinued operations, net of income taxes:							
Income (loss) from operations	4,086	6,632	3,059	4,625	(3,456)	778	(21,609)
Loss on divestiture of operations	(1,170)	(356)	(2,280)	(939)	(2,025)	(10,852)	(65,016)
Income (loss) from discontinued operations	2,916	6,276	779	3,686	(5,481)	(10,074)	(86,625)
Net income (loss)	18,642	15,263	7,607	(80,836)	3,473	1,827	(106,244)
(Earnings) loss attributable to noncontrolling interests	(451)	239	(41)	(790)	(416)	(82)	(754)
Income (loss) attributable to Kindred	$ 18,191	$ 15,502	$ 7,566	$ (81,626)	$ 3,057	$ 1,745	$ (106,998)
Amounts attributable to Kindred stockholders:							
Income (loss) from continuing operations	$ 15,275	$ 9,226	$ 6,787	$ (85,312)	$ 8,538	$ 11,819	$ (20,373)
Income (loss) from discontinued operations	2,916	6,276	779	3,686	(5,481)	(10,074)	(86,625)
Net income (loss)	$ 18,191	$ 15,502	$ 7,566	$ (81,626)	$ 3,057	$ 1,745	$ (106,998)
Earnings (loss) per common share:							
Basic:							
Income (loss) from continuing operations	$ 0.29	$ 0.17	$ 0.13	$ (1.65)	$ 0.16	$ 0.22	$ (0.39)
Discontinued operations:							
Income (loss) from operations	0.08	0.13	0.05	0.09	(0.06)	0.01	(0.41)

Loss on divestiture of operations	(0.02)	(0.01)	(0.04)	(0.02)	(0.04)	(0.20)	(1.24)
Income (loss) from discontinued operations	0.06	0.12	0.01	0.07	(0.10)	(0.19)	(1.65)
Net income (loss)	$ 0.35	$ 0.29	$ 0.14	$ (1.58)	$ 0.06	$ 0.03	$ (2.04)
Diluted:							
Income (loss) from continuing operations	$ 0.29	$ 0.17	$ 0.13	$ (1.65)	$ 0.16	$ 0.22	$ (0.39)
Discontinued operations:							
Income (loss) from operations	0.08	0.13	0.05	0.09	(0.06)	0.01	(0.41)
Loss on divestiture of operations	(0.02)	(0.01)	(0.04)	(0.02)	(0.04)	(0.20)	(1.24)
Income (loss) from discontinued operations	0.06	0.12	0.01	0.07	(0.10)	(0.19)	(1.65)
Net income (loss)	$ 0.35	$ 0.29	$ 0.14	$ (1.58)	$ 0.06	$ 0.03	$ (2.04)
Shares used in computing earnings (loss) per common share:							
Basic	51,603	51,664	51,676	51,692	52,062	52,265	52,323
Diluted	51,638	51,675	51,709	51,692	52,083	52,284	52,323

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Operating Data

(Unaudited)

(In thousands)

	2012 Quarters				2013 Quarters		
	First	Second	Third	Fourth	First	Second	Third
Revenues:							
Hospital division	$ 683,068	$ 648,152	$ 636,463	$ 647,794	$ 677,246	$ 623,877	$ 608,506
Nursing center division	285,032	279,353	282,223	283,451	283,771	278,191	277,668
Rehabilitation division:							
Skilled nursing rehabilitation services	253,595	253,181	252,201	244,558	257,585	248,331	243,968
Hospital rehabilitation services	74,369	73,402	71,899	73,910	74,523	69,777	68,296
	327,964	326,583	324,100	318,468	332,108	318,108	312,264
Home health and hospice division	28,432	28,872	35,943	50,093	51,621	53,039	53,801
	1,324,496	1,282,960	1,278,729	1,299,806	1,344,746	1,273,215	1,252,239
Eliminations:							
Skilled nursing rehabilitation services	(28,953)	(28,481)	(27,805)	(26,788)	(30,161)	(30,122)	(29,414)
Hospital rehabilitation services	(25,023)	(24,496)	(23,904)	(24,463)	(24,505)	(23,976)	(23,191)
Nursing centers	(636)	(875)	(861)	(1,006)	(1,213)	(1,001)	(1,161)
	(54,612)	(53,852)	(52,570)	(52,257)	(55,879)	(55,099)	(53,766)
	$ 1,269,884	$ 1,229,108	$ 1,226,159	$ 1,247,549	$ 1,288,867	$ 1,218,116	$ 1,198,473

Income (loss) from continuing operations:								
Operating income (loss):								
Hospital division	$ 151,491	$ 131,933	$ 130,798	$ 146,649	$ 149,644	$ 131,958	$ 112,290	(a)
Nursing center division	32,810	35,030	37,865	31,276	28,519	35,381	30,304	
Rehabilitation division:								
Skilled nursing rehabilitation services	10,904	19,519	16,996	21,074	12,074	20,307	(8,571)	(b)
Hospital rehabilitation services	16,116	17,860	16,977	18,792	18,132	19,573	18,215	(c)
	27,020	37,379	33,973	39,866	30,206	39,880	9,644	
Home health and hospice division	2,341	2,789	3,645	4,933	2,786	3,961	1,085	(d)
Corporate:								
Overhead	(42,728)	(44,723)	(45,883)	(45,729)	(45,582)	(43,199)	(39,151)	(e)
Insurance subsidiary	(482)	(600)	(545)	(500)	(509)	(384)	(482)	
	(43,210)	(45,323)	(46,428)	(46,229)	(46,091)	(43,583)	(39,633)	
Impairment charges	(498)	(111)	(406)	(108,127)	(187)	(457)	(441)	
Transaction costs	(485)	(597)	(482)	(667)	(944)	(108)	(613)	
Operating income	169,469	161,100	158,965	67,701	163,933	167,032	112,636	
Rent	(76,947)	(78,186)	(79,312)	(79,047)	(78,982)	(79,864)	(79,269)	
Depreciation and amortization	(39,470)	(40,655)	(41,304)	(42,623)	(42,650)	(39,631)	(37,591)	
Interest, net	(26,287)	(26,455)	(26,451)	(27,683)	(28,083)	(27,609)	(24,398)	(f)
Income (loss) from continuing operations before income taxes	26,765	15,804	11,898	(81,652)	14,218	19,928	(28,622)	
Provision for income taxes	11,039	6,817	5,070	2,870	5,264	8,027	(9,003)	
	$ 15,726	$ 8,987	$ 6,828	$ (84,522)	$ 8,954	$ 11,901	$ (19,619)	

(a) Includes costs of $5.5 million in connection with the closing of a TC hospital and a litigation charge of $0.7 million.

(b) Includes $23.1 million of litigation charges.

(c) Includes $0.3 million of severance and retirement costs.

(d) Includes $0.6 million of severance and retirement costs and $0.5 million of costs associated with closing a home health location.

(e) Includes $1.0 million of severance and retirement costs and $0.5 million of fees associated with the modification of certain of the Company s senior debt.

(f) Includes $0.1 million of charges associated with the modification of certain of the Company s senior debt.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Operating Data (Continued)

(Unaudited)

(In thousands)

	2012 Quarters				2013 Quarters		
	First	Second	Third	Fourth	First	Second	Third
Rent:							
Hospital division	$ 50,375	$ 51,218	$ 52,197	$ 51,632	$ 50,711	$ 51,381	$ 50,929
Nursing center division	23,861	24,326	24,300	24,432	25,207	25,487	25,450
Rehabilitation division:							
Skilled nursing rehabilitation services	1,440	1,408	1,356	1,238	1,235	1,197	1,123
Hospital rehabilitation services	78	39	2	21	17	19	19
	1,518	1,447	1,358	1,259	1,252	1,216	1,142
Home health and hospice division	615	609	805	1,111	1,186	1,155	1,193
Corporate	578	586	652	613	626	625	555
	$ 76,947	$ 78,186	$ 79,312	$ 79,047	$ 78,982	$ 79,864	$ 79,269
Depreciation and amortization:							
Hospital division	$ 19,343	$ 19,844	$ 20,060	$ 20,373	$ 20,453	$ 18,266	$ 17,483
Nursing center division	6,749	7,076	7,298	7,458	7,662	7,150	6,830
Rehabilitation division:							
Skilled nursing rehabilitation services	2,660	2,752	2,811	2,945	3,112	2,878	2,461
Hospital rehabilitation services	2,324	2,323	2,328	2,334	2,331	2,319	2,281
	4,984	5,075	5,139	5,279	5,443	5,197	4,742
Home health and hospice division	898	925	1,137	1,482	1,526	1,615	1,638
Corporate	7,496	7,735	7,670	8,031	7,566	7,403	6,898
	$ 39,470	$ 40,655	$ 41,304	$ 42,623	$ 42,650	$ 39,631	$ 37,591
Capital expenditures, excluding acquisitions (including discontinued operations):							
Hospital division:							
Routine	$ 10,345	$ 9,095	$ 9,015	$ 9,817	$ 10,271	$ 5,593	$ 6,421

Development	9,949	11,289	14,334	6,693	2,388	5,079	3,235
	20,294	20,384	23,349	16,510	12,659	10,672	9,656
Nursing center division:							
Routine	4,229	3,417	4,965	8,153	5,819	4,259	5,584
Development	673	1,087	843	5,454		7	
	4,902	4,504	5,808	13,607	5,819	4,266	5,584
Rehabilitation division:							
Skilled nursing rehabilitation services:							
Routine	326	569	707	672	605	464	860
Development							
	326	569	707	672	605	464	860
Hospital rehabilitation services:							
Routine	46	60	125	117	32	45	31
Development							
	46	60	125	117	32	45	31
Home health and hospice division:							
Routine	124	145	160	1,187	195	339	522
Development							
	124	145	160	1,187	195	339	522
Corporate:							
Routine:							
Information systems	6,864	15,195	10,842	17,440	5,289	6,436	7,298
Other	172	278	125	985	159	294	2,436
	$ 32,728	$ 41,135	$ 41,116	$ 50,518	$ 24,758	$ 22,516	$ 26,387

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Condensed Consolidating Statement of Operations

(Unaudited)

(In thousands)

	Three months ended September 30, 2013									
			Rehabilitation division							
	Hospital division (a)	Nursing center division	Skilled nursing services (b)	Hospital services (c)	Total	Home health and hospice division (d)	Corporate (e)	Transaction-related costs	Eliminations	Co
	$ 608,506	$ 277,668	$ 243,968	$ 68,296	$ 312,264	$ 53,801	$	$	$ (53,766)	$
	269,295	134,068	220,267	45,872	266,139	43,184	21,022		(103)	
	65,351	13,155	750	28	778	2,277	251			
	50,929	25,450	1,123	19	1,142	1,193	555			
	161,568	100,321	31,342	4,150	35,492	7,237	18,359	613	(53,663)	
	2	(180)	180	31	211	18	1			
	418	23								
	17,483	6,830	2,461	2,281	4,742	1,638	6,898			
	203	13	63		63	6	25,348			
	(8)	(19)	(50)		(50)		(1,158)			
	565,241	279,661	256,136	52,381	308,517	55,553	71,276	613	(53,766)	
s	$ 43,265	$ (1,993)	$ (12,168)	$ 15,915	$ 3,747	$ (1,752)	$ (71,276)	$ (613)	$	

$

	Three months ended September 30, 2012									
	Rehabilitation division									
	Hospital division (f)	Nursing center division	Skilled nursing services	Hospital services	Total	Home health and hospice division	Corporate	Transaction-related costs	Eliminations	Co
	$ 636,463	$ 282,223	$ 252,201	$ 71,899	$ 324,100	$ 35,943	$	$	$ (52,570)	$
	283,611	138,153	224,283	50,724	275,007	26,332	32,008	(350)		
	67,820	14,831	704	33	737	1,557	184			
	52,197	24,300	1,356	2	1,358	805	652			
	154,286	91,769	10,216	4,165	14,381	4,409	16,969	832	(52,570)	
	(52)	(395)	2		2		(2,733)			
	284	122								
n										
	20,060	7,298	2,811	2,328	5,139	1,137	7,670			
	231	15	36		36	4	26,377			
	(5)	(17)					(190)			
	578,432	276,076	239,408	57,252	296,660	34,244	80,937	482	(52,570)	
n										
	$ 58,031	$ 6,147	$ 12,793	$ 14,647	$ 27,440	$ 1,699	$ (80,937)	$ (482)	$	
r										
s										
n										

$

(a) Includes costs of $5.5 million in connection with the closing of a TC hospital and a litigation charge of $0.7 million.
(b) Includes $23.1 million of litigation charges.
(c) Includes $0.3 million of severance and retirement costs.
(d) Includes $0.6 million of severance and retirement costs and $0.5 million of costs associated with closing a home health location.
(e) Includes $1.0 million of severance and retirement costs and $0.6 million of fees and charges associated with the modification of certain of the Company s senior debt.
(f) Includes a lease cancellation charge of $0.6 million incurred in connection with the closing of a TC hospital.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Condensed Consolidating Statement of Operations (Continued)

(Unaudited)

(In thousands)

	Nine months ended September 30, 2013							
	Rehabilitation division							
Hospital vision (a,b)	Nursing center division (a)	Skilled nursing services (a,c)	Hospital services (a,d)	Total	Home health and hospice division (a,e)	Corporate (a,f)	Transaction-related costs	Eliminations
1,909,629	$ 839,630	$ 749,884	$ 212,596	$ 962,480	$ 158,461	$	$	$ (164,744)
837,573	408,679	674,985	144,528	819,513	123,228	75,943		(411)
201,579	40,178	2,346	90	2,436	6,840	639		
153,021	76,144	3,555	55	3,610	3,534	1,806		
476,508	297,405	48,524	11,999	60,523	20,543	53,245	1,665	(164,333)
77	(836)	219	59	278	18	(520)		
1,002	83							
56,202	21,642	8,451	6,931	15,382	4,779	21,867		
564	41	232		232	6	82,045		
(16)	(42)	(152)		(152)		(2,588)		
1,726,510	843,294	738,160	163,662	901,822	158,948	232,437	1,665	(164,744)
183,119	$ (3,664)	$ 11,724	$ 48,934	$ 60,658	$ (487)	$ (232,437)	$ (1,665)	$

Nine months ended September 30, 2012								
		Rehabilitation division						
Hospital division (g)	Nursing center division (h)	Skilled nursing services	Hospital services	Total	Home health and hospice division	Corporate	Transaction-related costs	Eliminations
1,967,683	$ 846,608	$ 758,977	$ 219,670	$ 978,647	$ 93,247	$	$	$ (161,034)
864,779	418,487	682,940	155,404	838,344	68,829	92,783	(350)	(69)
210,106	44,697	2,251	127	2,378	3,826	579		
153,790	72,487	4,204	119	4,323	2,029	1,816		
478,923	278,697	26,365	13,163	39,528	11,817	49,778	1,914	(160,965)
(347)	(978)	2	23	25		(8,179)		
636	379							
59,247	21,123	8,223	6,975	15,198	2,960	22,901		
810	52	36		36	4	79,044		
(46)	(39)	(1)		(1)		(667)		
1,767,898	834,905	724,020	175,811	899,831	89,465	238,055	1,564	(161,034)
199,785	$ 11,703	$ 34,957	$ 43,859	$ 78,816	$ 3,782	$ (238,055)	$ (1,564)	$

(a) Includes one-time bonus costs of $20.4 million (hospital division $8.0 million, nursing center division $5.0 million, rehabilitation division $6.3 million (skilled nursing rehabilitation services $5.0 million and hospital rehabilitation services $1.3 million), home health and hospice division $0.8 million and corporate $0.3 million).
(b) Includes costs of $5.5 million in connection with the closing of a TC hospital and a litigation charge of $0.7 million.
(c) Includes $23.1 million of litigation charges.
(d) Includes $0.3 million of severance and retirement costs.
(e) Includes $0.6 million of severance and retirement costs and $0.5 million of costs associated with closing a home health location.
(f) Includes $1.0 million of severance and retirement costs and $2.0 million of fees and charges associated with the modification of certain of the Company s senior debt.
(g) Includes severance ($2.5 million), other miscellaneous costs ($1.1 million) and lease cancellation charges ($1.5 million) incurred in connection with the closing of a regional office and two TC hospitals, and $5.0 million for employment related lawsuits.
(h) Includes $0.9 million incurred in connection with the cancellation of a sub-acute unit project.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Operating Data

(Unaudited)

	2012 Quarters				2013 Quarters		
	First	Second	Third	Fourth	First	Second	Third
ospital vision data:							
nd of period ata:							
umber of ospitals:							
ransitional are	104	103	102	102	102	102	102
patient habilitation	5	5	5	5	5	5	5
	109	108	107	107	107	107	107
umber of censed beds:							
ransitional are	7,469	7,419	7,380	7,380	7,380	7,380	7,394
patient habilitation	185	215	215	215	215	215	215
	7,654	7,634	7,595	7,595	7,595	7,595	7,609
evenue mix :							
ledicare	63	62	61	63	63	61	59
ledicaid	6	6	6	6	5	6	7
ledicare dvantage	10	11	11	10	10	11	11
ommercial surance and her	21	21	22	21	22	22	23
dmissions:							
ledicare	10,767	9,989	9,831	9,936	10,649	9,756	9,266
ledicaid	925	919	915	839	685	744	789
ledicare dvantage	1,532	1,649	1,494	1,453	1,583	1,537	1,461
ommercial surance and her	2,546	2,342	2,357	2,247	2,226	2,121	2,144

	15,770	14,899	14,597	14,475	15,143	14,158	13,660
dmissions ix %:							
ledicare	68	67	68	69	70	69	68
ledicaid	6	6	6	6	5	5	6
ledicare dvantage	10	11	10	10	10	11	11
ommercial surance and her	16	16	16	15	15	15	15
atient days:							
ledicare	264,930	250,081	244,189	248,315	261,311	241,790	230,780
ledicaid	32,848	30,568	33,671	31,697	28,776	30,447	31,608
ledicare dvantage	43,392	46,071	44,138	42,458	44,639	44,695	43,391
ommercial surance and her	75,351	73,331	72,394	69,552	73,512	66,706	68,583
	416,521	400,051	394,392	392,022	408,238	383,638	374,362
verage ngth of ay:							
ledicare	24.6	25.0	24.8	25.0	24.5	24.8	24.9
ledicaid	35.5	33.3	36.8	37.8	42.0	40.9	40.1
ledicare dvantage	28.3	27.9	29.5	29.2	28.2	29.1	29.7
ommercial surance and her	29.6	31.3	30.7	31.0	33.0	31.5	32.0
Veighted verage	26.4	26.9	27.0	27.1	27.0	27.1	27.4
evenues per dmission:							
ledicare	$ 39,802	$ 40,043	$ 39,423	$ 40,963	$ 39,956	$ 38,884	$ 39,078
ledicaid	42,937	42,150	41,591	43,487	51,441	48,141	51,891
ledicare dvantage	44,297	42,661	46,465	45,790	44,397	45,348	46,793
ommercial surance and her	57,715	59,384	60,002	61,313	65,694	65,537	63,947
Veighted verage	43,314	43,503	43,602	44,752	44,723	44,065	44,546
evenues per atient day:							
ledicare	$ 1,618	$ 1,599	$ 1,587	$ 1,639	$ 1,628	$ 1,569	$ 1,569
ledicaid	1,209	1,267	1,130	1,151	1,225	1,176	1,295
ledicare dvantage	1,564	1,527	1,573	1,567	1,574	1,559	1,576
ommercial surance and her	1,950	1,897	1,954	1,981	1,989	2,084	1,999

Weighted average	1,640	1,620	1,614	1,652	1,659	1,626	1,625
Medicare case mix index (discharged patients only)	1.18	1.18	1.16	1.15	1.18	1.18	1.16
Average daily census	4,577	4,396	4,287	4,261	4,536	4,216	4,069
Occupancy %	68.3	64.9	63.9	63.6	67.5	62.5	60.0
Annualized employee turnover %	22.0	21.5	20.2	19.8	22.2	21.6	21.1

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Operating Data (Continued)

(Unaudited)

	2012 Quarters				2013 Quarters		
	First	Second	Third	Fourth	First	Second	Third
sing er sion :							
of od :							
nber of ities:							
sing ers:							
ned or ed	99	99	99	98	98	98	98
aged	4	4	4	4	4	4	4
sted g ities	6	6	6	6	6	6	6
	109	109	109	108	108	108	108
nber of sed :							
sing ers:							
ned or ed	12,747	12,795	12,795	12,741	12,741	12,741	12,741
aged	485	485	485	485	485	485	485
sted g ities	413	341	341	341	341	341	341
	13,645	13,621	13,621	13,567	13,567	13,567	13,567
enue %:							
icare	35	35	34	35	35	34	33
icaid	36	37	37	37	36	36	39
	8	8	8	7	8	8	7

icare antage ate and r	21	20	21	21	21	22	21
ent (a):							
icare	184,273	178,799	173,627	170,509	175,642	166,291	161,181
icaid	548,718	549,131	554,260	549,053	533,317	533,032	542,265
icare antage	55,238	50,688	50,355	48,687	55,478	54,593	47,565
ate and r	238,158	232,488	238,386	239,446	228,210	228,875	228,698
	1,026,387	1,011,106	1,016,628	1,007,695	992,647	982,791	979,709
ent day % (a):							
icare	18	18	17	17	18	17	17
icaid	54	54	55	54	54	54	55
icare antage	5	5	5	5	5	6	5
ate and r	23	23	23	24	23	23	23
enues patient (a):							
icare A	$ 504	$ 505	$ 515	$ 536	$ 525	$ 525	$ 524
l icare luding B)	546	550	560	574	562	564	566
icaid	185	187	188	190	190	190	199
icaid of ider s) (b)	163	165	166	167	168	167	177
icare antage	427	421	422	429	427	431	427
ate and r	248	244	249	253	262	261	255
ghted age	278	276	277	281	286	283	283
rage y us (a)	11,279	11,111	11,050	10,953	11,029	10,800	10,649
nissions	11,538	10,646	10,482	10,814	11,475	10,708	10,387
upancy)	83.7	82.6	82.0	81.5	82.2	80.5	79.4
icare age th of	30.4	31.3	31.9	30.7	30.2	31.0	31.6

(a)							
ualized							
loyee							
over %	38.4	40.4	39.8	39.6	41.0	43.8	43.5

(a) Excludes managed facilities.

(b) Provider taxes are recorded in other operating expenses for all periods presented.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

Operating Data (Continued)

(Unaudited)

	2012 Quarters				2013 Quarters		
	First	Second	Third	Fourth	First	Second	Third
abilitation sion data:							
ed nursing bilitation ices:							
enue mix %:							
pany-operated	11	11	11	11	12	12	12
-affiliated	89	89	89	89	88	88	88
s of service (at of period)	1,722	1,730	1,735	1,726	1,729	1,713	1,768
enue per site	$ 147,268	$ 146,347	$ 145,361	$ 141,690	$ 148,979	$ 144,968	$ 137,991
rapist uctivity %	80.3	80.4	80.5	80.5	81.1	80.4	80.4
pital bilitation ices:							
enue mix %:							
pany-operated	34	33	33	33	33	34	34
-affiliated	66	67	67	67	67	66	66
s of services nd of period):							
tient bilitation units	100	102	104	105	103	103	99
C hospitals	125	125	123	123	123	123	122
-acute units	19	20	20	21	8	8	7
patient units	111	115	117	119	98	104	104
r	5	5	5	5			
	360	367	369	373	332	338	332
enue per site	$ 206,580	$ 200,006	$ 194,849	$ 198,150	$ 224,466	$ 206,441	$ 205,711
ualized loyee turnover	19.6	16.9	17.3	16.9	10.4	13.2	14.0

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The following discussion of the Company s exposure to market risk contains forward-looking statements that involve risks and uncertainties. Given the unpredictability of interest rates as well as other factors, actual results could differ materially from those projected in such forward-looking information.

The Company s exposure to market risk relates to changes in the prime rate, federal funds rate and LIBOR which affect the interest paid on certain borrowings.

The following table provides information about the Company s financial instruments that are sensitive to changes in interest rates. The table presents principal cash flows and related weighted average interest rates by expected maturity date.

Interest Rate Sensitivity

Principal (Notional) Amount by Expected Maturity

Average Interest Rate

(Dollars in thousands)

	Expected maturities							Fair value
	2013	2014	2015	2016	2017	Thereafter	Total	9/30/13
Liabilities:								
Long-term debt, including amounts due within one year:								
Fixed rate:								
Notes	$	$	$	$	$	$ 550,000	$ 550,000	$ 587,125
Other	26	109	116	123	10		384	367(a)
	$ 26	$ 109	$ 116	$ 123	$ 10	$ 550,000	$ 550,384	$ 587,492
Average interest rate	6.0%	6.0%	6.0%	6.0%	6.0%	8.3%		
Variable rate:								
ABL Facility (b)	$	$	$	$	$	$ 57,400	$ 57,400	$ 57,400
Term Loan Facility (c,d)	3,937	7,875	7,875	7,875	7,875	750,094	785,531	783,567
Other (e)	59	232	3,720				4,011	4,011
	$ 3,996	$ 8,107	$ 11,595	$ 7,875	$ 7,875	$ 807,494	$ 846,942	$ 844,978

(a) Calculated based upon the net present value of future principal and interest payments using a discount rate of 6%.

(b) Interest on borrowings under the Company s ABL Facility is payable at a rate per annum equal to the applicable margin plus, at the Company s option, either: (1) LIBOR determined by reference to the costs of funds for Eurodollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs, or (2) a base rate determined by reference to the highest of: (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate plus one-half of 1.00% and (c) LIBOR as described in subclause (1) plus 1.00%. At September 30, 2013, the applicable margin for borrowings under the ABL Facility was 2.75% with respect to LIBOR borrowings and 1.75% with respect to base rate borrowings. The applicable margin is subject to adjustment each fiscal quarter, based upon average historical excess availability during the preceding quarter.

(c) Interest on borrowings under the Term Loan Facility is payable at a rate per annum equal to an applicable margin plus, at the Company s option, either: (1) LIBOR determined by reference to the costs of funds for Eurodollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs, or (2) a base rate determined by reference to the highest of: (a) the prime rate of JPMorgan Chase Bank, N.A., (b) the federal funds effective rate plus one-half of 1.00% and (c) LIBOR described in subclause (1) plus 1.00%. LIBOR is subject to an interest rate floor of 1.00%. The applicable margin for borrowings under the Term Loan Facility is 3.25% with respect to LIBOR borrowings and 2.25% with respect to base rate borrowings. The expected maturities for the Term Loan Facility exclude the original issue discount of approximately $7 million.

(d) In December 2011, the Company entered into two interest rate swap agreements to hedge its floating interest rate on an aggregate of $225 million of outstanding Term Loan Facility debt. The interest rate swaps have an effective date of January 9, 2012, and expire on January 11, 2016. The Company is required to make payments based upon a fixed interest rate of 1.8925% calculated on the notional amount of $225 million. In exchange, the Company will receive interest on $225 million at a variable interest rate that is based upon the three-month LIBOR, subject to a minimum rate of 1.5%.

(e) Interest based upon LIBOR plus 4%.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures and Changes in Internal Control Over Financial Reporting

The Company has carried out an evaluation under the supervision and with the participation of management, including the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2013, the Company s disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports that the Company files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required.

There has been no change in the Company s internal control over financial reporting during the Company s quarter ended September 30, 2013, that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is a party to various legal actions (some of which are not insured), and regulatory and other governmental and internal audits and investigations in the ordinary course of business (including investigations resulting from the Company s obligation to self-report suspected violations of law by the Company). The Company cannot predict the ultimate outcome of pending litigation and regulatory and other governmental and internal audits and investigations. These matters could potentially subject the Company to sanctions, damages, recoupments, fines and other penalties. The DOJ, CMS or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company s businesses in the future which may, either individually or in the aggregate, have a material adverse effect on the Company s business, financial position, results of operations and liquidity. See Note 15 of the notes to condensed consolidated financial statements for a description of the Company s other pending legal proceedings.

The Company s subsidiary, RehabCare, and two other unrelated therapy services providers, are defendants in a whistleblower lawsuit styled United States ex rel. Health Dimensions Rehabilitation, Inc. v. RehabCare Group, Inc., et al. currently pending in federal district court for the Eastern District of Missouri. This action was filed under seal in federal district court for the District of Minnesota on July 11, 2007. The U.S. Attorney s Office in Minnesota intervened in the lawsuit on December 5, 2011 by filing a new complaint and demand for jury trial in federal district court for the District of Minnesota. The lawsuit was transferred to federal district court for the Eastern District of Missouri in May 2012.

The lawsuit arises from a subcontractor arrangement between RehabCare and one of the unrelated therapy service providers and fees paid under and in connection with the transaction. The parties entered into the transaction in 2006. The new complaint alleges violations of the federal civil False Claims Act based upon an underlying claim that the transaction violated the federal Anti-Kickback Statute, 42 U.S.C. §1320a-7(b). In July 2013, all parties filed motions for summary judgment, which were denied on August 30, 2013. The trial on the matter began on September 23, 2013, but has been recessed until February 3, 2014 while the parties continue settlement discussions. Any potential settlement of this lawsuit would be subject to, among other items, the negotiation and execution of a definitive settlement agreement, any necessary approvals by the parties, approval of the OIG (which may include other remedial actions), and final court approval of the related settlement agreement. The Company disputes the allegations in the complaint and continues to defend this lawsuit vigorously.

The United States is seeking single damages in the amount of approximately $226 million, treble damages, per claim penalties of $5,500 to $11,000 for each claim submitted, other unspecified damages, attorneys fees and costs. Based upon the results of certain pre-trial motions, new facts associated with the case and settlement discussions occurring in September 2013, the Company recorded an additional $23 million loss provision in the third quarter of 2013 (for a total loss reserve of $25 million) related to this matter. The Company continues to evaluate the loss provision in light of potentially relevant factual and legal developments, including information learned through rulings on dispositive motions, settlement discussions and other rulings. The expected loss reserve is based upon currently available information and is subject to significant judgment and a variety of assumptions, and known and unknown uncertainties. Given the uncertainty of litigation, the actual loss may vary significantly from the current reserve, which does not represent the Company s maximum loss exposure. At this time, no estimate of the possible loss or range of loss, in excess of the amount accrued, can be made regarding this lawsuit.

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PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total number of shares (or units) purchased (a)	Average price paid per share (or unit) (b)	Total number of shares (or units) purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs
Month #1 (July 1 July 31)	306	$ 15.36		$
Month #2 (August 1 August 31)	1,063	15.02		
Month #3 (September 1 September 30)				
Total	1,369	$ 15.10		$

(a) These amounts represent shares of the Company s common stock, par value $0.25 per share, withheld to offset tax withholding obligations that occurred upon the vesting and release of service-based restricted share awards previously granted under the Company s stock-based compensation plans for its employees (the Withheld Shares). The total tax withholding obligation is calculated by dividing the closing price of the Company s common stock on the New York Stock Exchange on the applicable vesting date to determine the total number of Withheld Shares required to satisfy such withholding obligation.

(b) The average price per share for each period was calculated by dividing the sum of the aggregate value of the Withheld Shares by the total number of Withheld Shares.

PART II. OTHER INFORMATION (Continued)

Item 6. Exhibits

2.1*	Amendment No. 2 to Asset Purchase Agreement dated as of April 24, 2013 (as amended by Amendment No. 1 dated June 14, 2013), dated as of August 29, 2013 by and between Kindred Healthcare Operating, Inc., Vibra Healthcare II, LLC, Kindred Healthcare, Inc. and Vibra Healthcare, LLC.
10.1	Employment Agreement dated as of July 10, 2013 by and between Kindred Healthcare Operating, Inc. and Richard A. Lechleiter. Exhibit 10.1 to the Company s Current Report on Form 8-K dated July 10, 2013 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.2	Employment Agreement dated as of July 15, 2013 by and between Kindred Healthcare Operating, Inc. and Jon B. Rousseau.
10.3	Change-in-Control Severance Agreement dated as of July 15, 2013 by and between Kindred Healthcare Operating, Inc. and Jon B. Rousseau.
10.4	Amendment and Restatement Agreement dated as of August 21, 2013 to the ABL Credit Agreement and the Security Agreement, by and among the Company, the other Credit Parties party thereto, the Consenting Lenders and JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent. Exhibit 10.1 to the Company s Current Report on Form 8-K dated August 21, 2013 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.5	Second Amendment and Restatement Agreement dated as of August 21, 2013 to the Amended and Restated Term Loan Credit Agreement and the Security Agreement, by and among the Company, the other Credit Parties party thereto, the Consenting Lenders and JPMorgan Chase Bank, N.A., as Administrative Agent and Collateral Agent. Exhibit 10.2 to the Company s Current Report on Form 8-K dated August 21, 2013 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.6	Employment Agreement dated as of September 30, 2013 by and between Kindred Healthcare Operating, Inc. and Steven L. Monaghan.
10.7	Change-in-Control Severance Agreement dated as of September 30, 2013 by and between Kindred Healthcare Operating, Inc. and Steven L. Monaghan.
10.8	Agreement Regarding Master Leases, dated as of September 30, 2013 between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating, Inc., as Tenant. Exhibit 10.1 to the Company s Current Report on Form 8-K dated September 30, 2013 (Comm. File No. 001-14057) is hereby incorporated by reference.
10.9	Amended and Restated Master Lease Agreement No. 5, dated as of September 30, 2013 between Ventas Realty, Limited Partnership, as Lessor and Kindred Healthcare, Inc. and Kindred Healthcare Operating,

	Inc., as Tenant. Exhibit 10.2 to the Company s Current Report on Form 8-K dated September 30, 2013 (Comm. File No. 001-14057) is hereby incorporated by reference.
31	Rule 13a-14(a)/15d-14(a) Certifications.
32	Section 1350 Certifications.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

*The Company will furnish supplementally to the SEC upon request a copy of any omitted exhibit or schedule.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KINDRED HEALTHCARE, INC.

Date: November 12, 2013 /s/ PAUL J. DIAZ
Paul J. Diaz
Chief Executive Officer

Date: November 12, 2013 /s/ RICHARD A. LECHLEITER
Richard A. Lechleiter
Executive Vice President and

Chief Financial Officer