KINDRED HEALTHCARE, INC
Form 10-Q
May 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2018

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 incorporation or organization)	(I.R.S. Employer Identification No.)

680 South Fourth Street Louisville, KY	40202
(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 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 No

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

Large accelerated filer	Accelerated filer	Emerging growth company
Non-accelerated filer	Smaller reporting company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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 April 30, 2018
Common stock, $0.25 par value	91,260,624 shares

KINDRED HEALTHCARE, INC.

FORM 10-Q

INDEX

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	Three months ended March 31, 2018	2017
Revenues	$1,513,789	$1,539,490
Salaries, wages and benefits	845,854	839,813
Supplies	75,008	80,101
Building rent	62,488	64,656
Equipment rent	8,689	8,887
Other operating expenses	135,717	158,824
General and administrative expenses (exclusive of depreciation and amortization expense included below)	265,372	275,503
Other (income) expense	(607)	30
Impairment charges	-	474
Restructuring charges	8,109	10,006
Depreciation and amortization	24,789	29,820
Interest expense	61,032	59,328
Investment income	(197)	(509)
	1,486,254	1,526,933
Income from continuing operations before income taxes	27,535	12,557
Provision for income taxes	1,228	2,234
Income from continuing operations	26,307	10,323
Discontinued operations, net of income taxes:		
Income (loss) from operations	(8,770)	5,059
Loss on divestiture of operations	(5,790)	(6,166)
Loss from discontinued operations	(14,560)	(1,107)
Net income	11,747	9,216
Earnings attributable to noncontrolling interests:		
Continuing operations	(12,792)	(10,483)
Discontinued operations	(660)	(4,481)
	(13,452)	(14,964)
Loss attributable to Kindred	$(1,705)	$(5,748)
Amounts attributable to Kindred stockholders:		
Income (loss) from continuing operations	$13,515	$(160)
Loss from discontinued operations	(15,220)	(5,588)
Net loss	$(1,705)	$(5,748)
Earnings (loss) per common share:		
Basic:		
Income (loss) from continuing operations	$0.15	$-

Discontinued operations:		
Income (loss) from operations	(0.11)	-
Loss on divestiture of operations	(0.06)	(0.07)
Loss from discontinued operations	(0.17)	(0.07)
Net loss	$(0.02)	$(0.07)
Diluted:		
Income (loss) from continuing operations	$0.15	$-
Discontinued operations:		
Income (loss) from operations	(0.11)	-
Loss on divestiture of operations	(0.06)	(0.07)
Loss from discontinued operations	(0.17)	(0.07)
Net loss	$(0.02)	$(0.07)
Shares used in computing earnings (loss) per common share:		
Basic	88,526	87,085
Diluted	88,526	87,085
Cash dividends declared and paid per common share	$-	$0.12

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)

	Three months ended March 31,	
	2018	2017
Net income	$11,747	$9,216
Other comprehensive income:		
Available-for-sale securities (Note 10):		
Change in unrealized investment gains	-	949
Reclassification of gains realized in net income	-	(1)
Net change	-	948
Interest rate swaps (Note 1):		
Change in unrealized gains	4,125	1,026
Reclassification of gains realized in net income, net of payments	(629)	(103)
Net change	3,496	923
Other comprehensive income	3,496	1,871
Comprehensive income	15,243	11,087
Earnings attributable to noncontrolling interests	(13,452)	(14,964)
Comprehensive income (loss) attributable to Kindred	$1,791	$(3,877)

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

(In thousands, except per share amounts)

	March 31, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 108,759	$ 160,254
Insurance subsidiary investments	22,407	22,546
Accounts receivable less allowance for loss of $67,227 March 31, 2018 and $96,899 December 31, 2017	1,165,044	1,122,532
Inventories	21,635	21,716
Income taxes	3,462	4,546
Assets held for sale	8,937	17,335
Other (Note 13)	69,828	60,610
	1,400,072	1,409,539
Property and equipment	1,686,791	1,682,965
Accumulated depreciation	(961,272)	(946,986)
	725,519	735,979
Goodwill	2,188,391	2,188,566
Intangible assets less accumulated amortization of $64,836 March 31, 2018 and $77,603 December 31, 2017	601,368	604,338
Insurance subsidiary investments	27,771	28,988
Other (Note 13)	263,242	265,307
Total assets (a)	$ 5,206,363	$ 5,232,717
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 147,143	$ 191,827
Salaries, wages and other compensation	337,838	352,179
Due to third party payors	26,772	35,321
Professional liability risks	60,671	60,767
Accrued lease termination fees	7,557	7,610
Other accrued liabilities (Note 13)	214,227	263,977
Long-term debt due within one year	14,482	14,638
	808,690	926,319
Long-term debt	3,266,364	3,146,972
Professional liability risks	276,551	276,829
Deferred tax liabilities	37,196	36,881
Deferred credits and other liabilities (Note 13)	492,170	497,954

Commitments and contingencies (Note 12)		
Equity:		
Stockholders' equity:		
Common stock, $0.25 par value; authorized 175,000 shares; issued 91,279 shares March 31, 2018 and 91,454 shares December 31, 2017	22,820	22,864
Capital in excess of par value	1,714,504	1,713,179
Accumulated other comprehensive income	9,675	6,179
Accumulated deficit	(1,632,432)	(1,618,896)
	114,567	123,326
Noncontrolling interests	210,825	224,436
Total equity	325,392	347,762
Total liabilities (a) and equity	$5,206,363	$5,232,717

(a) The Company's consolidated assets as of March 31, 2018 and December 31, 2017 include total assets of variable interest entities of $405.5 million and $405.8 million, respectively, which can only be used to settle the obligations of the variable interest entities. The Company's consolidated liabilities as of March 31, 2018 and December 31, 2017 include total liabilities of variable interest entities of $43.5 million and $43.9 million, respectively. See note 1 of the notes to unaudited condensed consolidated financial statements.

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

(In thousands)

	Three months ended March 31, 2018	2017
Cash flows from operating activities:		
Net income	$11,747	$9,216
Add back loss from discontinued operations, net of income taxes	14,560	1,107
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation expense	22,322	25,191
Amortization of intangible assets	2,467	4,629
Amortization of stock-based compensation costs	4,261	3,026
Amortization of deferred financing costs	4,254	4,132
Payment of capitalized lender fees related to debt amendment	-	(5,403)
Provision for doubtful accounts	2,910	6,425
Deferred income taxes	411	1,227
Impairment charges	-	474
Other	270	6,258
Change in operating assets and liabilities:		
Accounts receivable	(77,785)	(79,752)
Inventories and other assets	(18,292)	(4,983)
Accounts payable	(19,680)	(10,425)
Income taxes	1,084	2,291
Due to third party payors	(8,135)	(4,745)
Other accrued liabilities	(38,743)	(42,973)
Net cash used in operating activities of discontinued operations	(34,054)	(8,293)
Net cash used in operating activities	(132,403)	(92,598)
Cash flows from investing activities:		
Routine capital expenditures	(15,910)	(10,346)
Development capital expenditures	(3,542)	(5,433)
Acquisitions, net of cash acquired	-	(3,150)
Sale of assets	13,225	-
Purchase of insurance subsidiary investments	-	(22,308)
Sale of insurance subsidiary investments	-	18,699
Net change in other investments	91	29
Other	(233)	154
Net cash provided by (used in) investing activities of discontinued operations	7,204	(1,601)
Net cash provided by (used in) investing activities	835	(23,956)
Cash flows from financing activities:		
Proceeds from borrowings under revolving credit	429,700	478,600
Repayment of borrowings under revolving credit	(310,200)	(343,400)

Repayment of term loan	(3,508)	(3,509)
Repayment of other long-term debt	(203)	(284)
Payment of deferred financing costs	(56)	(79)
Payment of dividend for mandatory redeemable preferred stock	-	(3,010)
Dividends paid	-	(10,228)
Contributions made by noncontrolling interests	165	-
Distributions to noncontrolling interests	(27,228)	(25,801)
Payroll tax payments for equity awards issuance	(3,044)	(2,255)
Net cash provided by financing activities	85,626	90,034
Change in cash, cash equivalents and restricted cash	(45,942)	(26,520)
Cash, cash equivalents and restricted cash at beginning of period	218,463	324,168
Cash, cash equivalents and restricted cash at end of period	$172,521	$297,648
Supplemental information:		
Interest payments	$76,283	$74,839
Income tax refunds	266	1,240
Distributions to noncontrolling interests:		
Continuing operations	(11,038)	(8,785)
Discontinued operations	(16,190)	(17,016)

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 a home health, hospice and community care business, transitional care ("TC") hospitals, inpatient rehabilitation hospitals ("IRFs"), and a contract rehabilitation services business across the United States (collectively, the "Company" or "Kindred"). At March 31, 2018, the Company's Kindred at Home division primarily provided home health, hospice, and community care services from 606 sites of service in 40 states. The Company's hospital division operated 75 TC hospitals (certified as long-term acute care ("LTAC") hospitals under the Medicare program) in 17 states. The Company's Kindred Rehabilitation Services division operated 19 IRFs and 98 hospital-based acute rehabilitation units ("ARUs") (certified as IRFs), and provided rehabilitation services primarily in hospitals and long-term care settings in 45 states.

Recently issued accounting requirements

In February 2018, the Financial Accounting Standards Board (the "FASB") issued authoritative guidance which permits a company to reclassify the income tax effects of the Tax Cuts and Jobs Act of 2017 (the "Tax Reform Act") on items within accumulated other comprehensive income to retained earnings. The new guidance is effective for annual and interim periods beginning after December 15, 2018 and early adoption is permitted. The Company will not elect to early adopt and the adoption of this standard is not expected to have a material impact on the Company's business, financial position, results of operations or liquidity.

In August 2017, the FASB issued authoritative guidance with the objective of improving the financial reporting of hedging relationships under United States generally accepted accounting principles ("GAAP") to better portray economic results and to simplify the application of the current hedge accounting guidance. The new guidance is effective for annual and interim periods beginning after December 15, 2018 and early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's business, financial position, results of operations or liquidity.

In January 2017, the FASB issued authoritative guidance that simplifies the measurement of goodwill impairment to a single-step test. The guidance removed step two of the goodwill impairment test, which required a hypothetical purchase price allocation. The measurement of goodwill impairment is now the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Under the revised guidance, failing step one will always result in goodwill impairment. The new guidance is effective for annual and interim periods beginning after December 15, 2019 and early adoption is permitted. The Company adopted the new guidance on January 1, 2017 on a prospective basis. If the Company fails step one of the goodwill impairment test under the new guidance, the results could materially impact the Company's financial position and results of operations but not its business or liquidity.

In June 2016, the FASB issued authoritative guidance for accounting for credit losses on financial instruments. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments and modifies the impairment model for available-for-sale debt securities. The new guidance is effective for annual periods beginning after December 15, 2019 and early adoption is permitted beginning after December 15,

2018. The adoption of this standard is not expected to have a material impact on the Company's business, financial position, results of operations, or liquidity.

In February 2016, the FASB issued amended authoritative guidance on accounting for leases. The new provisions require that a lessee of operating leases recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The lease liability will be equal to the present value of lease payments, with the right-of-use asset based upon the lease liability. The classification criteria for distinguishing between finance (or capital) leases and operating leases are substantially similar to the previous lease guidance, but with no explicit bright lines. As such, operating leases will result in straight-line rent expense similar to current practice. For short-term leases (term of 12 months or less), a lessee is permitted to make an accounting election not to recognize lease assets and lease liabilities, which would generally result in lease expense being recognized on a straight-line basis over the lease term. The guidance is effective for annual and interim periods beginning after December 15, 2018, and will require application of the new guidance at the beginning of the earliest comparable period presented. The Company will not elect early adoption and will apply the modified retrospective approach as required. The adoption of this standard is expected to have a material impact on the Company's financial position. The Company does not expect an impact on its business, results of operations or liquidity.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Revenue recognition

On January 1, 2018, the Company adopted Accounting Standards Codification ("ASC") 606, Revenue from Contracts with Customers, and all of the related amendments (the "New Revenue Standard"). The New Revenue Standard requires entities to recognize the amount of revenue it expects for the transfer of goods or services to customers. The adoption of this standard had an immaterial impact on the Company's reported total revenues as compared to what reported amounts would have been under the prior standard, and the Company expects the impact of adoption in future periods will be immaterial. The Company's accounting policies under the New Revenue Standard were applied prospectively and are noted below.

Revenues are recognized as performance obligations are satisfied, which is over time as patient services are rendered throughout the length of stay, in an amount that reflects the consideration the Company expects to receive in exchange for services. A performance obligation is defined as a promise in a contract to transfer a distinct good or service to the customer. Substantially all of the Company's contracts with patients and customers have a single performance obligation as the promise to transfer services is not distinct or separately identifiable from other promises in the contract.

The transaction price for the Company's contracts represents its best estimate of the consideration the Company expects to receive and includes assumptions regarding variable consideration as applicable. These variable considerations include estimated amounts due from patients and third party payors for healthcare services provided, including anticipated settlements under reimbursement agreements with Medicare, Medicaid, Medicare Advantage, Medicaid Managed, and other third party payors. Revenues under third party agreements are subject to examination and retroactive adjustment. Provisions for estimated third party adjustments are provided in the period the related services are rendered to the extent it is probable that a significant reversal of cumulative revenue will not occur. Any remaining differences between the amounts accrued and subsequent settlements are recorded in the periods in which the interim or final settlements are determined.

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

	Three months ended March 31, 2018	2017
Medicare	$791,842	$814,768
Medicaid	93,765	105,427
Medicare Advantage	142,224	116,503
Medicaid Managed	55,861	51,013
Other	452,063	475,385
	1,535,755	1,563,096
Eliminations	(21,966)	(23,606)

	$1,513,789	$1,539,490

8

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Revenue recognition (Continued)

A summary of revenues by business segment follows (in thousands):

	Three months ended March 31,	
	2018	2017
Revenues:		
Kindred at Home:		
Home health	$453,759	$450,831
Hospice	183,628	179,378
	637,387	630,209
Hospital division	547,630	556,646
Kindred Rehabilitation Services:		
Kindred Hospital Rehabilitation Services	178,219	178,115
RehabCare	172,519	198,126
	350,738	376,241
	1,535,755	1,563,096
Eliminations:		
Kindred Hospital Rehabilitation Services	(19,321)	(21,148)
RehabCare	(1,993)	(1,878)
Hospitals	(652)	(580)
	(21,966)	(23,606)
	$1,513,789	$1,539,490

ASC 606 adoption impact

On January 1, 2018, the Company adopted the New Revenue Standard using the modified retrospective transition method. The Company recognized the cumulative effect of initially applying the New Revenue Standard to all contracts not completed as of the date of adoption, resulting in an $11.8 million adjustment, net of taxes, on January 1, 2018 to accounts receivable and accumulated deficit. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The impact of adoption of the New Revenue Standard was primarily related to the following: (i) recognizing contractual revenues due to variable considerations subject to estimation during the period of service within the Kindred at Home division (included within the Medicare and Medicare Advantage payor types) and (ii) recognizing contractual revenues earlier due to variable considerations arising from the historical collectability of the Company’s hospital division’s private payor portfolio (included within the other payor type).

The Company reclassified approximately $3.8 million of other operating expenses to contractual revenues for the three months ended March 31, 2018 as a result of the New Revenue Standard. The Company reclassified the net hospice room and board charges previously recorded as other operating expenses to contractual revenues. In accordance with the New Revenue Standard definition of performance obligations, the Company does not view the room and board charges as separate and distinct from the patient services, and as such, classifies the net charges as contractual revenues. The remaining reclassifications resulted from certain bad debts considered implicit price concessions or contractual revenues under the New Revenue Standard, while the remaining bad debts recorded in other operating expenses are related to credit risk or limitations on a customer's ability to pay.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION (Continued)

ASC 606 adoption impact (Continued)

The impact of adoption on the Company’s accompanying unaudited condensed consolidated statement of operations and unaudited condensed consolidated balance sheet was as follows (in thousands):

	Three months ended March 31, 2018		
	As reported	Without adoption of ASC 606	Effect of change
Statement of operations:			
Revenues	$1,513,789	$ 1,517,196	$(3,407)
Other operating expenses	135,717	139,581	(3,864)
Income from continuing operations before income taxes	27,535	27,078	457
	As of March 31, 2018		
Balance sheet:			
Current assets:			
Accounts receivable less allowance for loss	$1,165,044	$ 1,176,354	$(11,310)
Equity:			
Accumulated deficit	$(1,632,432)	$ (1,621,122)	$(11,310)

Equity

The following table sets forth the changes in equity attributable to noncontrolling interests and equity attributable to Kindred stockholders for the three months ended March 31, 2018 and 2017 (in thousands):

For the three months ended March 31, 2018	Amounts attributable to Kindred stockholders	Noncontrolling interests	Total equity
Balance at December 31, 2017	$ 123,326	$ 224,436	$347,762
Adoption of the New Revenue Standard as of January 1, 2018	(11,767)	-	(11,767)
Comprehensive income (loss):			