KINDRED HEALTHCARE, INC
Form 10-Q
November 06, 2015

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, 2015

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	40202-2412
(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, 2015
Common stock, $0.25 par value	83,796,755 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, 2015	2014	Nine months ended September 30, 2015	2014
Revenues	$1,764,516	$1,228,918	$5,273,958	$3,762,925
Salaries, wages and benefits	922,140	601,813	2,704,920	1,826,602
Supplies	96,551	70,719	288,059	215,269
Rent	96,244	77,643	284,786	233,872
Other operating expenses	207,837	169,582	617,681	511,786
General and administrative expenses (exclusive of depreciation and amortization expense included below)	310,041	237,503	1,050,948	713,521
Other income	(650)	(260)	(1,699)	(594)
Litigation contingency expense	31,462	–	130,387	4,600
Impairment charges	–	–	6,726	–
Depreciation and amortization	39,329	38,748	116,889	117,012
Interest expense	56,440	22,515	176,128	128,844
Investment income	(432)	(344)	(2,203)	(2,975)
	1,758,962	1,217,919	5,372,622	3,747,937
Income (loss) from continuing operations before income taxes	5,554	10,999	(98,664)	14,988
Provision for income taxes	12,523	3,777	9,183	5,289
Income (loss) from continuing operations	(6,969)	7,222	(107,847)	9,699
Discontinued operations, net of income taxes:				
Income (loss) from operations	2,269	(8,677)	(1,744)	(24,887)
Gain (loss) on divestiture of operations	–	1,387	983	(3,637)
Income (loss) from discontinued operations	2,269	(7,290)	(761)	(28,524)
Net loss	(4,700)	(68)	(108,608)	(18,825)
(Earnings) loss attributable to noncontrolling interests:				
Continuing operations	(9,900)	(4,372)	(30,482)	(13,729)
Discontinued operations	1	78	32	401
	(9,899)	(4,294)	(30,450)	(13,328)
Loss attributable to Kindred	$(14,599)	$(4,362)	$(139,058)	$(32,153)
Amounts attributable to Kindred stockholders:				
Income (loss) from continuing operations	$(16,869)	$2,850	$(138,329)	$(4,030)
Income (loss) from discontinued operations	2,270	(7,212)	(729)	(28,123)
Net loss	$(14,599)	$(4,362)	$(139,058)	$(32,153)
Earnings (loss) per common share:				
Basic:				

Income (loss) from continuing operations	$(0.20)	$0.04	$(1.65)	$(0.07)
Discontinued operations:				
Income (loss) from operations	0.03	(0.13)	(0.02)	(0.44)
Gain (loss) on divestiture of operations	–	0.02	0.01	(0.06)
Income (loss) from discontinued operations	0.03	(0.11)	(0.01)	(0.50)
Net loss	$(0.17)	$(0.07)	$(1.66)	$(0.57)
Diluted:				
Income (loss) from continuing operations	$(0.20)	$0.04	$(1.65)	$(0.07)
Discontinued operations:				
Income (loss) from operations	0.03	(0.13)	(0.02)	(0.44)
Gain (loss) on divestiture of operations	–	0.02	0.01	(0.06)
Income (loss) from discontinued operations	0.03	(0.11)	(0.01)	(0.50)
Net loss	$(0.17)	$(0.07)	$(1.66)	$(0.57)
Shares used in computing earnings (loss) per common share:				
Basic	86,184	62,863	83,960	56,443
Diluted	86,184	62,902	83,960	56,443
Cash dividends declared and paid per common share	$0.12	$0.12	$0.36	$0.36

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE LOSS

(Unaudited)

(In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Net loss	$(4,700)	$(68)	$(108,608)	$(18,825)
Other comprehensive income (loss):				
Available-for-sale securities (Note 9):				
Change in unrealized investment gains (losses)	(978)	93	(841)	577
Reclassification of gains realized in net loss	–	(27)	–	(2,130)
Net change	(978)	66	(841)	(1,553)
Interest rate swaps (Note 1):				
Change in unrealized gains (losses)	(909)	2,162	(2,173)	(884)
Reclassification of ineffectiveness realized in net loss	59	–	88	84
Reclassification of losses realized in net loss, net of payments	12	12	–	809
Net change	(838)	2,174	(2,085)	9
Income tax (expense) benefit related to items of other comprehensive income (loss)	699	(846)	1,149	891
Other comprehensive income (loss)	(1,117)	1,394	(1,777)	(653)
Comprehensive income (loss)	(5,817)	1,326	(110,385)	(19,478)
Earnings attributable to noncontrolling interests	(9,899)	(4,294)	(30,450)	(13,328)
Comprehensive loss attributable to Kindred	$(15,716)	$(2,968)	$(140,835)	$(32,806)

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

(In thousands, except per share amounts)

	September 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$120,891	$164,188
Insurance subsidiary investments	103,856	99,951
Accounts receivable less allowance for loss of $51,531 – September 30, 2015 and $52,855 – December 31, 2014	1,216,214	944,219
Inventories	27,252	25,702
Deferred tax assets	74,221	82,391
Income taxes	10,571	8,575
Interest deposit on senior unsecured notes held in escrow	–	23,438
Other	66,891	41,598
	1,619,896	1,390,062
Property and equipment	2,120,809	1,978,153
Accumulated depreciation	(1,164,969)	(1,076,049)
	955,840	902,104
Goodwill	2,646,766	997,597
Intangible assets less accumulated amortization of $88,779 – September 30, 2015 and $68,043 – December 31, 2014	783,774	400,700
Assets held for sale	1,526	3,475
Insurance subsidiary investments	201,026	166,045
Deferred tax assets	–	11,174
Proceeds from senior unsecured notes held in escrow	–	1,350,000
Acquisition deposit	–	195,000
Other	295,168	236,807
Total assets (a)	$6,503,996	$5,652,964
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$182,154	$175,725
Salaries, wages and other compensation	442,730	358,857
Due to third party payors	59,498	43,957
Professional liability risks	62,020	64,137
Other accrued liabilities	346,309	189,980
Long-term debt due within one year	32,527	24,607
	1,125,238	857,263
Long-term debt	3,126,359	2,852,531

Professional liability risks	273,874	243,614
Deferred tax liabilities	20,850	–
Deferred credits and other liabilities	307,164	213,584
Commitments and contingencies (Note 12)		
Equity:		
Stockholders' equity:		
Common stock, $0.25 par value; authorized 175,000 shares; issued 83,759 shares – September 30, 2015 and 69,977 shares – December 31, 2014	20,940	17,494
Capital in excess of par value	1,741,736	1,586,692
Accumulated other comprehensive loss	(4,328)	(2,551)
Accumulated deficit	(301,878)	(159,768)
	1,456,470	1,441,867
Noncontrolling interests	194,041	44,105
Total equity	1,650,511	1,485,972
Total liabilities (a) and equity	$6,503,996	$5,652,964

(a) The Company’s consolidated assets as of September 30, 2015 include total assets of variable interest entities of $376.2 million, which can only be used to settle the obligations of the variable interest entities. The Company’s consolidated liabilities as of September 30, 2015 include total liabilities of variable interest entities of $35.8 million. See note 1 of the notes to unaudited condensed consolidated financial statements.

See accompanying notes.

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KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

(In thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Cash flows from operating activities:				
Net loss	$(4,700))	$(68)	$(108,608)	$(18,825)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Depreciation and amortization	39,595	39,579	117,521	121,805
Amortization of stock-based compensation costs	3,194	694	15,764	9,657
Amortization of deferred financing costs	3,554	1,982	10,155	21,211
Payment of capitalized lender fees related to debt issuance	–	–	(28,012)	(19,125)
Provision for doubtful accounts	11,014	14,695	29,817	35,588
Deferred income taxes	3,556	(32,777)	(894)	(11,274)
Impairment charges	–	9	6,726	673
(Gain) loss on divestiture of discontinued operations	–	(1,387)	(983)	3,637
Other	3,485	175	10,457	2,289
Change in operating assets and liabilities:				
Accounts receivable	25,990	10,392	(13,399)	(102,503)
Inventories and other assets	8,767	(2,899)	44,181	(12,886)
Accounts payable	(353)	(3,592)	(12,788)	(22,469)
Income taxes	37,491	29,832	33,646	18,769
Due to third party payors	15,008	28,907	(3,965)	14,540
Other accrued liabilities	(14,311)	4,497	(6,551)	(16,765)
Net cash provided by operating activities	132,290	90,039	93,067	24,322
Cash flows from investing activities:				
Routine capital expenditures	(35,422)	(21,263)	(80,691)	(67,425)
Development capital expenditures	(5,760)	(1,570)	(12,066)	(2,693)
Acquisitions, net of cash acquired	(2,002)	(38)	(663,757)	(24,136)
Acquisition deposit	–	–	195,000	–
Sale of assets	3,884	8,948	7,061	22,909
Proceeds from senior unsecured notes offering held in escrow	–	–	1,350,000	–
Interest in escrow for senior unsecured notes	–	–	23,438	–
Purchase of insurance subsidiary investments	(16,357)	(74,101)	(59,186)	(97,394)
Sale of insurance subsidiary investments	15,987	8,447	50,780	34,967
Net change in insurance subsidiary cash and cash equivalents	(2,633)	65,928	(8,396)	54,372
Proceeds from note receivable	25,000	–	25,000	–
Change in other investments	176	317	375	1,027
Other	1,383	(3)	590	(537)
Net cash provided by (used in) investing activities	(15,744)	(13,335)	828,148	(78,910)

Cash flows from financing activities:				
Proceeds from borrowings under revolving credit	259,700	311,500	1,414,850	1,468,515
Repayment of borrowings under revolving credit	(349,700)	(355,100)	(1,319,850)	(1,724,615)
Proceeds from issuance of term loan, net of discount	–	–	199,000	997,500
Proceeds from issuance of senior unsecured notes	–	–	–	500,000
Repayment of Gentiva debt	–	–	(1,177,363)	–
Repayment of senior unsecured notes	–	–	–	(550,000)
Repayment of term loan	(3,003)	(2,500)	(9,008)	(786,063)
Repayment of other long-term debt	(500)	(58)	(1,400)	(215)
Payment of deferred financing costs	(301)	(504)	(3,284)	(3,152)
Equity offering, net of offering costs	–	16,376	–	220,353
Issuance of common stock in connection with employee benefit plans	329	1,530	534	6,217
Payment of costs associated with issuance of common stock and tangible equity units	–	–	(915)	–
Payment of dividend for mandatory redeemable preferred stock	(2,703)	–	(8,135)	–
Dividends paid	(10,065)	(7,754)	(30,067)	(20,840)
Contributions made by noncontrolling interests	1,492	–	1,492	–
Distributions to noncontrolling interests	(10,685)	(4,009)	(31,823)	(9,604)
Other	245	183	1,457	2,304
Net cash provided by (used in) financing activities	(115,191)	(40,336)	(964,512)	100,400
Change in cash and cash equivalents	1,355	36,368	(43,297)	45,812
Cash and cash equivalents at beginning of period	119,536	45,416	164,188	35,972
Cash and cash equivalents at end of period	$120,891	$81,784	$120,891	$81,784
Supplemental information:				
Interest payments	$81,474	$12,222	$147,924	$91,888
Income tax payments (refunds)	(27,414)	909	(26,275)	(20,656)
Issuance of common stock in Gentiva Merger (see Note 2)	15	–	177,456	–

See accompanying notes.

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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, a home health, hospice and community care business, inpatient rehabilitation hospitals (“IRFs”), a contract rehabilitation services business, nursing centers and assisted living facilities across the United States (collectively, the “Company” or “Kindred”). At September 30, 2015, the Company’s hospital division operated 95 TC hospitals (certified as long-term acute care (“LTAC”) hospitals under the Medicare program) in 22 states. The Company’s Kindred at Home division (formerly known as the care management division) primarily provided home health, hospice and community care services from 626 sites of service in 41 states. The Company’s rehabilitation division (now known as the Kindred Rehabilitation Services division) provided rehabilitation services primarily in hospitals and long-term care settings and operated 18 IRFs. The Company’s nursing center division operated 90 nursing centers and seven assisted living facilities in 18 states.

Gentiva merger

On October 9, 2014, the Company entered into an Agreement and Plan of Merger (the “Gentiva Merger Agreement”) with Gentiva Health Services, Inc. (“Gentiva”), providing for the Company’s acquisition of Gentiva (the “Gentiva Merger”). On February 2, 2015, the Company consummated the Gentiva Merger, with Gentiva continuing as the surviving company and the Company’s wholly owned subsidiary.

Discontinued operations

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 gains, losses or impairments associated with these transactions were classified as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all periods presented in accordance with the authoritative guidance in effect through December 31, 2014. Effective January 1, 2015, the authoritative guidance modified the requirements for reporting discontinued operations. A disposal is now required to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on the Company’s operations and financial results.

Assets held for sale at September 30, 2015 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 Note 4 for a summary of discontinued operations.

Recently issued accounting requirements

In September 2015, the Financial Accounting Standards Board (the “FASB”) issued authoritative guidance that eliminates the requirement to restate prior period financial statements for measurement period adjustments. The new guidance requires that the cumulative impact of a measurement period adjustment (including the impact on prior periods) be recognized in the reporting period in which the adjustment is identified. The new guidance is effective for interim and annual periods beginning after December 15, 2015 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 April 2015, the FASB issued authoritative guidance on accounting for fees paid in a cloud computing arrangement. The new provisions will help entities determine whether a cloud computing arrangement contains a software license that should be accounted for as internal-use software and capitalized or as a service contract. For public companies, the new standard is effective for annual periods, including interim periods, beginning after December 15, 2015. Early adoption is permitted and transition may be elected retrospectively or prospectively. 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 April 2015, the FASB issued authoritative guidance which changes the balance sheet presentation requirements for debt issuance costs. To simplify presentation of debt issuance costs, the amendments require that debt issuance costs, other than those paid to the lender, be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts. In August 2015, the FASB issued an update based upon a Securities and Exchange Commission ("SEC") Staff Announcement, which addresses the application of the guidance to line-of-credit arrangements. The SEC announcement confirms that these arrangements are not within the scope of the new guidance. The guidance is effective for interim and annual periods beginning

NOTE 1 – BASIS OF PRESENTATION (Continued)

Recently issued accounting requirements (Continued)

on or after December 15, 2015. The guidance should be applied on a retrospective basis, 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 February 2015, the FASB issued authoritative guidance which changes the evaluation of certain legal entities for consolidation. Specifically, the guidance (i) modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities, (ii) eliminates the presumption that a general partner should consolidate a limited partnership, (iii) affects the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships and (iv) provides a scope exception from consolidation guidance for reporting entities with interest in legal entities in certain investment funds. The guidance is effective for all interim and annual reporting periods beginning after December 15, 2015. Early adoption is permitted for all entities. The guidance is not expected to have an impact on the Company's business, financial position, results of operations or liquidity.

In January 2015, the FASB issued authoritative guidance which eliminated from United States generally accepted accounting principles ("GAAP") the concept of extraordinary items. The FASB issued this update as part of its initiative to reduce complexity in accounting standards, also referred to as the Simplification Initiative. The guidance is effective for all interim and annual reporting periods beginning after December 15, 2015. Early adoption is permitted for all entities. The guidance is not expected to have an impact on the Company's business, financial position, results of operations or liquidity.

In May 2014, the FASB issued authoritative guidance which changes the requirements for recognizing revenue when entities enter into contracts with customers. Under the new provisions, an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. It also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In July 2015, the FASB finalized a one year deferral of the new revenue standard with an updated effective date for interim and annual periods beginning on or after December 15, 2017. Entities are not permitted to adopt the standard earlier than the original effective date, which was on or after December 15, 2016. The Company is still assessing this guidance.

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, 2015 and 2014 (in thousands):

For the nine months ended September 30, 2015:	Amounts attributable to Kindred stockholders	Noncontrolling interests	Total equity
Balance at December 31, 2014	$ 1,441,867	$ 44,105	$ 1,485,972
Comprehensive income (loss):			
Net income (loss)	(139,058)	30,450	(108,608)
Other comprehensive loss	(1,777)	–	(1,777)
	(140,835)	30,450	(110,385)
Issuance of common stock in connection with employee benefit plans	534	–	534
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(10,055)	–	(10,055)
Income tax benefit in connection with the issuance of common stock under employee benefit plans	1,806	–	1,806
Stock-based compensation amortization	15,764	–	15,764
Dividends paid	(30,067)	–	(30,067)
Acquired noncontrolling interests	–	149,817	149,817
Contributions made by noncontrolling interests	–	1,492	1,492
Distributions to noncontrolling interests	–	(31,823)	(31,823)
Issuance of common stock in Gentiva Merger	177,456	–	177,456
Balance at September 30, 2015	$ 1,456,470	$ 194,041	$ 1,650,511
For the nine months ended September 30, 2014:			
Balance at December 31, 2013	$ 1,082,657	$ 38,559	$ 1,121,216
Comprehensive income (loss):			
Net income (loss)	(32,153)	13,328	(18,825)
Other comprehensive loss	(653)	–	(653)
	(32,806)	13,328	(19,478)
Issuance of common stock in connection with employee benefit plans	6,217	–	6,217
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(6,129)	–	(6,129)
Income tax benefit in connection with the issuance of common stock under employee benefit plans	1,229	–	1,229

Stock-based compensation amortization	9,657	–	9,657
Equity offering, net of offering costs	220,353	–	220,353
Dividends paid	(20,840)	–	(20,840)
Contribution made by noncontrolling interests	–	833	833
Distributions to noncontrolling interests	–	(9,604)	(9,604)
Balance at September 30, 2014	$ 1,260,338	$ 43,116	$ 1,303,454

Property and equipment

Beginning January 1, 2015, the Company changed the estimated useful life of certain technology and medical equipment based upon a detailed review of actual utilization. The change in estimate extended the expected useful life by two to three years depending on the equipment category and has been accounted for prospectively. The impact from this change in accounting estimate was an increase to income (loss) from continuing operations before income taxes of approximately $3 million ($2 million net of income taxes) in the third quarter of 2015 and approximately $11 million ($7 million net of income taxes) for the nine months ended September 30, 2015.

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Goodwill

In connection with the preparation of the Company's operating results for the third quarter of 2015, the Company determined that the impact of the regulatory changes announced on July 31, 2015 in connection with the LTAC Legislation (as defined) and related to the Company's hospital reporting unit was an impairment triggering event. The regulatory changes create new Medicare criteria and payment rules for LTAC hospitals. The Company tested the recoverability of the hospital reporting unit goodwill and determined that goodwill was not impaired.

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 senior secured term loan facility (the "Prior Term Loan Facility") entered into in June 2011. The interest rate swaps had an effective date of January 9, 2012, and will 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 these interest rate swaps continue to qualify for cash flow hedge accounting treatment at September 30, 2015. However, an amendment to the Prior Term Loan Facility 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 agreements.

In March 2014, the Company entered into an additional interest rate swap agreement to hedge its floating interest rate on an aggregate of $400 million of debt outstanding under the Term Loan Facility (as defined in Note 10). On April 8, 2014, the Company completed a novation of a portion of its $400 million swap agreement to two new counterparties, each in the amount of $125 million. The original swap contract was not amended, terminated or otherwise modified. The interest rate swap had an effective date of April 9, 2014 and will expire on April 9, 2018 and continues to apply to the Term Loan Facility. The Company is required to make payments based upon a fixed interest rate of 1.867% calculated on the notional amount of $400 million. In exchange, the Company will receive interest on $400 million at a variable interest rate that is based upon the three-month LIBOR, subject to a minimum rate of 1.0%. The Company determined this interest rate swap continues to qualify for cash flow hedge accounting treatment at September 30, 2015.

The Company records the effective portion of the gain or loss on these derivative financial instruments in accumulated other comprehensive income (loss) as a component of stockholders' equity and records the ineffective portion of the gain or loss on these derivative financial instruments as interest expense. For the three months and nine months ended September 30, 2015 and 2014, the ineffectiveness related to the interest rate swaps was immaterial.

The aggregate fair value of the interest rate swaps recorded in other accrued liabilities was $5.8 million and $3.7 million at September 30, 2015 and December 31, 2014, respectively. See Note 13.

Variable interest entities

The Company follows the provisions of the authoritative guidance for determining whether an entity is a VIE. In order to determine if the Company is a primary beneficiary of a VIE for financial reporting purposes, it must consider whether it has the power to direct activities of the VIE that most significantly impact the performance of the VIE and whether the Company has the obligation to absorb losses or the right to receive returns that would be significant to the VIE. The Company consolidates a VIE when it is the primary beneficiary.

In January 2015, the Company completed the acquisition of Centerre Healthcare Corporation ("Centerre"), which operated 11 IRFs. During the third quarter of 2015, Kindred opened two additional IRFs. Each entity operating one of the IRFs is subject to a partnership and a management services agreement with the Company. Under GAAP, the Company determined that all of the entities acquired or opened qualify as VIEs and that the Company is the primary beneficiary in all but one arrangement. The Company holds an equity interest and acts as manager in each of the entities. Through the management services agreement, the Company is delegated necessary responsibilities to provide management services, administrative services and direction of the day-to-day operations. Based on the Company's assessment of the most significant activities of the IRFs, the manager has the ability to direct the majority of those activities in 12 of the entities.

The analysis upon which the consolidation determination rests is complex, involves uncertainties, and requires significant judgment on various matters, some of which could be subject to different interpretations.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Variable interest entities (Continued)

The carrying amounts and classifications of the assets and liabilities of the consolidated VIEs as of September 30, 2015 are as follows (in thousands):

Assets:	
Current assets:	
Cash and cash equivalents	$41,310
Accounts receivable, net	30,662
Inventories	1,601
Other	3,330
	76,903
Property and equipment, net	14,649
Goodwill	261,702
Intangible assets, net	22,884
Other	54
Total assets	$376,192
Liabilities:	
Current liabilities:	
Accounts payable	$20,860
Salaries, wages and other compensation	2,916
Other accrued liabilities	3,390
Long-term debt due within one year	2,660
	29,826
Long-term debt	1,547
Deferred credits and other liabilities	4,434
Total liabilities	$35,807

Other information

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for quarterly reports on Form 10-Q of Regulation S-X and do not include all of the disclosures normally required by GAAP 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, 2014 filed with the SEC as Exhibit 99.1 to the Form 8-K on September 17, 2015. The accompanying condensed consolidated balance sheet at December 31, 2014 was derived from audited consolidated financial statements, but does not include all disclosures required by GAAP.

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 GAAP 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.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 2 – GENTIVA MERGER

On October 9, 2014, the Company entered into the Gentiva Merger Agreement, providing for the Company's acquisition of Gentiva. On February 2, 2015, the Company consummated the Gentiva Merger, with Gentiva continuing as the surviving company and the Company's wholly owned subsidiary.

At the effective time of the Gentiva Merger, each share of common stock, par value $0.10 per share, of Gentiva ("Gentiva Common Stock") issued and outstanding immediately prior to the effective time of the Gentiva Merger (other than shares held by Kindred, Gentiva and any wholly owned subsidiaries (which were cancelled) and shares owned by stockholders who properly exercised and perfected a demand for appraisal rights under Delaware law), including each deferred share unit, were converted into the right to receive (i) $14.50 in cash (the "Cash Consideration"), without interest, and (ii) 0.257 of a validly issued, fully paid and nonassessable share of Kindred common stock, par value $0.25 per share (the "Stock Consideration"). Kindred issued 9.7 million shares of common stock as the Stock Consideration. The purchase price totaled $722.3 million and was comprised of $544.8 million of Cash Consideration and $177.5 million of Stock Consideration. The Company also assumed $1.2 billion of long-term debt, which was paid off upon consummation of the Gentiva Merger.

The Company used the net proceeds from the Financing Transactions (as defined in Note 10), to fund the Cash Consideration for the Gentiva Merger, repay Gentiva's existing debt and pay related transaction fees and expenses.

Operating results in the third quarter of 2015 included transaction and integration costs totaling $1.1 million, and retention and severance costs totaling $1.9 million related to the Gentiva Merger. Operating results for the nine months ended September 30, 2015 included transaction and integration costs totaling $35.2 million, retention and severance costs totaling $58.8 million, a lease termination charge of $0.8 million and financing costs totaling $23.4 million related to the Gentiva Merger. Operating results in the third quarter of 2014 and for the nine months ended September 30, 2014 included transaction costs totaling $3.2 million and $5.3 million, respectively, related to the Gentiva Merger. Transaction, integration, retention and severance costs were recorded as general and administrative expenses, the lease termination charge was recorded as rent expense and financing costs were recorded as general and administrative expenses ($6.0 million) and as interest expense ($17.4 million).

A note receivable totaling $25 million was acquired in the Gentiva Merger. The note receivable was collected in full during the third quarter of 2015 and the Company received all of the cash proceeds.

As of December 31, 2014, Gentiva provided home health services, hospice services and community care services serving patients through approximately 491 locations in 40 states.

Purchase price allocation

The Gentiva Merger purchase price of $722.3 million was allocated on a preliminary basis to the estimated fair value of the tangible and intangible assets, and goodwill.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 2 – GENTIVA MERGER (Continued)

Purchase price allocation (Continued)

The following is the preliminary Gentiva Merger purchase price allocation (in thousands):

Cash and cash equivalents	$64,695
Accounts receivable	258,438
Deferred tax assets	31,535
Other current assets	123,429
Property and equipment	46,860
Identifiable intangible assets:	
Certificates of need (indefinite life)	256,921
Medicare certifications (indefinite life)	94,500
Trade names (indefinite life)	22,200
Trade name	15,600
Non-compete agreements	1,820
Leasehold interests	1,439
Total identifiable intangible assets	392,480
Other assets	74,309
Current portion of long-term debt	(53,075)
Accounts payable and other current liabilities	(289,205)
Long-term debt, less current portion	(1,124,288)
Deferred tax liabilities	(47,748)
Other liabilities	(131,185)
Noncontrolling interests	(3,992)
Total identifiable net assets	(657,747)
Goodwill	1,380,028
Net assets	$722,281

The preliminary fair value allocation was measured primarily using a discounted cash flows methodology, which is considered a Level 3 input (as described in Note 13).

The value of gross contractual accounts receivable before determining uncollectable amounts totaled $272.3 million. Accounts estimated to be uncollectable totaled $13.9 million.

The weighted average life of the definite lived intangible assets consisting primarily of a trade name is three years.

The aggregate goodwill arising from the Gentiva Merger is based upon the expected future cash flows of the Gentiva operations, which reflect both growth expectations and cost savings from combining the operations of the Company and Gentiva. Goodwill is not amortized and is not deductible for income tax purposes. Goodwill was preliminarily assigned to the Company’s home health reporting unit ($610.8 million), hospice reporting unit ($604.7 million) and community care reporting unit ($164.5 million).

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 2 – GENTIVA MERGER (Continued)

Purchase price allocation (Continued)

The unaudited pro forma net effect of the Gentiva Merger assuming the acquisition occurred as of January 1, 2014 is as follows (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Revenues	$1,764,516	$1,726,924	$5,435,657	$5,246,476
Income (loss) from continuing operations attributable to Kindred	(14,501)	3,913	(56,221)	(46,119)
Loss attributable to Kindred	(12,231)	(3,299)	(56,950)	(74,242)
Earnings (loss) per common share:				
Basic:				
Income (loss) from continuing operations	(0.17)	0.04	(0.66)	(0.54)
Net loss	(0.14)	(0.04)	(0.67)	(0.87)
Diluted:				
Income (loss) from continuing operations	(0.17)	0.04	(0.66)	(0.54)
Net loss	(0.14)	(0.04)	(0.67)	(0.87)

The unaudited pro forma financial data has been derived by combining the historical financial results of the Company and the operations acquired in the Gentiva Merger for the periods presented. The unaudited pro forma financial data includes transaction, integration, retention and severance costs, a lease termination charge and financing costs totaling $135.2 million incurred by both the Company and Gentiva in connection with the Gentiva Merger. These costs have been eliminated from the results of operations for 2015 and have been reflected as expenses incurred as of January 1, 2014 for purposes of the pro forma financial presentation. Revenues and earnings before interest, income taxes, transaction, integration, retention and severance costs associated with Gentiva aggregated $525.0 million and $67.5 million, respectively, in the third quarter of 2015 and $1.4 billion and $168.7 million, respectively, since the date of the Gentiva Merger.

NOTE 3 – OTHER ACQUISITIONS

The following is a summary of the Company's other 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 (as defined in Note 10). 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 2015, the Company acquired a home health business for $2.0 million.

In addition, during the nine months ended September 30, 2015, the Company acquired two home-based primary care practices for $12.1 million.

On January 1, 2015, the Company completed the acquisition of Centerre for a purchase price of approximately $195 million in cash (the “Centerre Acquisition”). During the nine months ended September 30, 2015, the Company paid approximately $4 million in cash for a working capital settlement. Centerre operated 11 IRFs with 614 beds through partnerships.

During the nine months ended September 30, 2014, the Company acquired the real estate of two previously leased nursing centers for $22.3 million. Annual rent associated with the nursing centers aggregated $2.0 million. The fair value of the assets acquired 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 4 – 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 Note 1 has been accounted for as discontinued operations. Accordingly, the results of operations of these businesses for all periods presented and the gains, losses or impairments associated with these transactions have been classified as discontinued operations, net of income taxes, in the accompanying unaudited condensed consolidated statement of operations based upon the authoritative guidance which was in effect through December 31, 2014. Effective January 1, 2015, the authoritative guidance modified the requirements for reporting discontinued operations. A disposal is now required to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on the Company's operations and financial results. At September 30, 2015, the Company held for sale six nursing centers reported as discontinued operations.

On December 27, 2014, the Company entered into an agreement with Ventas, Inc. ("Ventas") to transition the operations under the leases for nine non-strategic nursing centers (the "2014 Expiring Facilities"). Each lease will terminate when the operation of such nursing center is transferred to a new operator, which is expected to occur during 2015. The current lease term for eight of these nursing centers is scheduled to expire on April 30, 2018. The current lease term for the ninth of these nursing centers is scheduled to expire on April 30, 2020. The Company will continue to operate these facilities until operations are transferred. Through September 30, 2015, the Company transferred the operations of three of the 2014 Expiring Facilities, resulting in a gain on divestiture of $1.6 million ($1.0 million net of income taxes). For accounting purposes, the 2014 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. Under the terms of the agreement, the Company incurred a $40 million termination fee in exchange for the early termination of the leases, which was paid to Ventas in January 2015.

During the nine months ended September 30, 2014, the Company reclassified as discontinued for all periods presented the operations of three TC hospitals and two nursing centers that were either closed or divested through a planned sale of such facility or the expiration of a lease. The Company recorded a loss on divestiture of $2.9 million ($1.7 million net of income taxes) for the nine months ended September 30, 2014 related to these divestitures.

The Company allowed the lease to expire on a TC hospital during the nine months ended September 30, 2014 resulting in a loss on divestiture primarily related to a write-off of an indefinite-lived intangible asset of $3.4 million ($2.1 million net of income taxes) for the nine months ended September 30, 2014. The Company reflected the operating results of this TC hospital as discontinued operations in the accompanying unaudited condensed consolidated statement of operations for all historical periods.

A summary of discontinued operations follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Revenues	$ 12,935	$ 25,182	$ 36,934	$ 278,360
Salaries, wages and benefits	5,306	13,563	17,877	117,945

Supplies	595	1,310	1,995	14,568
Rent	1,951	5,713	6,608	39,557
Other operating expenses	2,001	4,675	7,008	53,742
General and administrative expenses	(920)	13,391	5,699	88,572
Other expense	–	–	–	–
Impairment charges	–	9	–	673
Depreciation	266	831	632	4,793
Interest expense	2	2	3	17
Investment income	(7)	(6)	(12)	(474)
	9,194	39,488	39,810	319,393
Income (loss) from operations before income taxes	3,741	(14,306)	(2,876)	(41,033)
Provision (benefit) for income taxes	1,472	(5,629)	(1,132)	(16,146)
Income (loss) from operations	2,269	(8,677)	(1,744)	(24,887)
Gain (loss) on divestiture of operations	–	1,387	983	(3,637)
Income (loss) from discontinued operations	2,269	(7,290)	(761)	(28,524)
Loss attributable to noncontrolling interests	1	78	32	401
Income (loss) attributable to Kindred	$ 2,270	$ (7,212)	$ (729)	$ (28,123)

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 4 – DISCONTINUED OPERATIONS (Continued)

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

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Revenues:				
Hospital division	$158	$242	$1,747	$25,936
Nursing center division	12,777	24,940	35,187	252,424
	$12,935	$25,182	$36,934	$278,360
Operating income (loss):				
Hospital division	$(14)	$(3,399)	$408	$(3,110)
Nursing center division	5,967	(4,367)	3,947	5,970
	$5,953	$(7,766)	$4,355	$2,860
Rent:				
Hospital division	$477	$602	$1,514	$3,722
Nursing center division	1,474	5,111	5,094	35,835
	$1,951	$5,713	$6,608	$39,557
Depreciation:				
Hospital division	$–	$439	$–	$1,422
Nursing center division	266	392	632	3,371
	$266	$831	$632	$4,793

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

	September 30, 2015	December 31, 2014
Long-term assets:		
Property and equipment, net	$ 1,405	$ 3,306
Other	121	169
	1,526	3,475
Current liabilities (included in other accrued liabilities)	–	–
	$ 1,526	$ 3,475

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, 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. Differences between the amounts accrued and subsequent settlements are recorded in the periods the interim or final settlements are determined.

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

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Medicare	$915,778	$500,039	$2,673,753	$1,566,537
Medicaid	210,688	150,260	610,911	452,321
Medicare Advantage	127,905	89,912	401,199	282,965
Medicaid Managed	52,736	35,088	147,137	87,102
Other	517,047	505,776	1,626,264	1,530,406
	1,824,154	1,281,075	5,459,264	3,919,331
Eliminations	(59,638)	(52,157)	(185,306)	(156,406)
	$1,764,516	$1,228,918	$5,273,958	$3,762,925

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 6 – EARNINGS (LOSS) PER SHARE

Earnings (loss) per common share are based upon the weighted average number of common shares outstanding during the respective periods. Because the Company is reporting a loss from continuing operations attributable to the Company for the three months ended September 30, 2015 and for the nine months ended September 30, 2015 and 2014, the diluted calculation of earnings per common share excludes the dilutive impact of stock options and tangible equity units. 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.

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,			
	2015		2014		2015		2014	
	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	$(16,869)	$(16,869)	$2,850	$2,850	$(138,329)	$(138,329)	$(4,030)	$(4,030)
Allocation to participating unvested restricted stockholders	–	–	(72)	(72)	–	–	–	–
Available to common stockholders	$(16,869)	$(16,869)	$2,778	$2,778	$(138,329)	$(138,329)	$(4,030)	$(4,030)
Discontinued operations, net of income taxes:								
Income (loss) from operations:								
As reported in Statement of Operations	$2,270	$2,270	$(8,599)	$(8,599)	$(1,712)	$(1,712)	$(24,486)	$(24,486)
Allocation to participating unvested restricted stockholders	–	–	218	218	–	–	–	–
Available to common stockholders	$2,270	$2,270	$(8,381)	$(8,381)	$(1,712)	$(1,712)	$(24,486)	$(24,486)

Gain (loss) on divestiture of operations:								
As reported in Statement of Operations	$–	$–	$1,387	$1,387	$983	$983	$(3,637)	$(3,637)
Allocation to participating unvested restricted stockholders	–	–	(35)	(35)	–	–	–	–
Available to common stockholders	$–	$–	$1,352	$1,352	$983	$983	$(3,637)	$(3,637)
Income (loss) from discontinued operations:								
As reported in Statement of Operations	$2,270	$2,270	$(7,212)	$(7,212)	$(729)	$(729)	$(28,123)	$(28,123)
Allocation to participating unvested restricted stockholders	–	–	183	183	–	–	–	–
Available to common stockholders	$2,270	$2,270	$(7,029)	$(7,029)	$(729)	$(729)	$(28,123)	$(28,123)
Net loss:								
As reported in Statement of Operations	$(14,599)	$(14,599)	$(4,362)	$(4,362)	$(139,058)	$(139,058)	$(32,153)	$(32,153)
Allocation to participating unvested restricted stockholders	–	–	111	111	–	–	–	–
Available to common stockholders	$(14,599)	$(14,599)	$(4,251)	$(4,251)	$(139,058)	$(139,058)	$(32,153)	$(32,153)
Shares used in the computation:								
Weighted average shares outstanding – basic computation	86,184	86,184	62,863	62,863	83,960	83,960	56,443	56,443
Dilutive effect of employee stock options		–		39		–		–
Dilutive effect of tangible equity units		–		–		–		–
Adjusted weighted average shares outstanding – diluted computation		86,184		62,902		83,960		56,443
Earnings (loss) per common share:								
Income (loss) from continuing operations	$(0.20)	$(0.20)	$0.04	$0.04	$(1.65)	$(1.65)	$(0.07)	$(0.07)
Discontinued operations:								
Income (loss) from operations	0.03	0.03	(0.13)	(0.13)	(0.02)	(0.02)	(0.44)	(0.44)
	–	–	0.02	0.02	0.01	0.01	(0.06)	(0.06)

Gain (loss) on divestiture of operations								
Income (loss) from discontinued operations	0.03	0.03	(0.11)	(0.11)	(0.01)	(0.01)	(0.50)	(0.50)
Net loss	$(0.17)	$(0.17)	$(0.07)	$(0.07)	$(1.66)	$(1.66)	$(0.57)	$(0.57)
Number of antidilutive stock options and tangible equity units excluded from shares used in the diluted earnings (loss) per common share computation		1,548		279		2,572		324

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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 Kindred at Home division (formerly the care management division), the rehabilitation division (now known as the Kindred Rehabilitation Services division) and the nursing center division. Based upon the authoritative guidance for business segments, the operating divisions represent six reportable operating segments, including (1) hospitals, (2) home health services, (3) hospice services, (4) hospital rehabilitation services (now known as Kindred Hospital Rehabilitation Services), (5) skilled nursing rehabilitation services (now known as RehabCare) and (6) nursing centers. These reportable operating segments are consistent with information used by the Company's President and Chief Executive Officer and its 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, including the transfer of five IRFs from the hospital division to the Kindred Hospital Rehabilitation Services business segment as of January 1, 2015. As a result, $51.0 million of goodwill was reallocated from the hospital division to the Kindred Hospital Rehabilitation Services business segment based upon the relative fair value of the five IRFs.

For segment purposes, the Company defines segment 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 litigation contingency expense, impairment charges, transaction costs and the allocation of support center overhead.

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,	
	2015	2014	2015	2014
Revenues:				
Hospital division	$579,497	$591,121	$1,847,186	$1,830,883
Kindred at Home:				
Home health	424,054	74,026	1,152,741	224,319
Hospice	181,140	12,160	478,202	37,557
	605,194	86,186	1,630,943	261,876
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services	149,435	93,139	453,543	281,279
RehabCare	219,518	246,732	708,904	754,369
	368,953	339,871	1,162,447	1,035,648
Nursing center division	270,510	263,897	818,688	790,924
	1,824,154	1,281,075	5,459,264	3,919,331
Eliminations:				
Kindred Hospital Rehabilitation Services	(22,081)	(22,172)	(69,284)	(68,260)
RehabCare	(35,943)	(29,209)	(111,994)	(85,848)
Nursing centers	(1,614)	(776)	(4,028)	(2,298)
	(59,638)	(52,157)	(185,306)	(156,406)
	$1,764,516	$1,228,918	$5,273,958	$3,762,925
Income (loss) from continuing operations:				
Operating income (loss):				
Hospital division	$95,983	$116,987	$361,061	$388,482
Kindred at Home:				
Home health	65,584	5,686	183,609	13,579
Hospice	33,707	1,103	76,424	4,972
	99,291	6,789	260,033	18,551
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services	42,141	23,030	131,236	74,312
RehabCare	14,544	17,242	44,933	54,945
	56,685	40,272	176,169	129,257
Nursing center division	35,923	35,437	112,763	108,418
Support center	(55,439)	(45,810)	(192,213)	(139,074)
Litigation contingency expense	(31,462)	–	(130,387)	(4,600)
Impairment charges	–	–	(6,726)	–

Transaction costs	(3,846)	(4,114)	(103,764)	(9,293)
Operating income	197,135	149,561	476,936	491,741
Rent	(96,244)	(77,643)	(284,786)	(233,872)
Depreciation and amortization	(39,329)	(38,748)	(116,889)	(117,012)
Interest, net	(56,008)	(22,171)	(173,925)	(125,869)
Income (loss) from continuing operations before income taxes	5,554	10,999	(98,664)	14,988
Provision for income taxes	12,523	3,777	9,183	5,289
	$(6,969)	$7,222	$(107,847)	$9,699

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,	
	2015	2014	2015	2014
Rent:				
Hospital division	$51,933	$50,790	$154,791	$152,964
Kindred at Home:				
Home health	9,174	1,927	25,214	5,899
Hospice	4,530	228	12,395	689
	13,704	2,155	37,609	6,588
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services	7,591	1,741	22,473	5,301
RehabCare	937	1,041	2,946	3,197
	8,528	2,782	25,419	8,498
Nursing center division	21,510	21,316	64,391	64,096
Support center	569	600	2,576	1,726
	$96,244	$77,643	$284,786	$233,872
Depreciation and amortization:				
Hospital division	$12,956	$16,336	$40,963	$49,275
Kindred at Home:				
Home health	4,653	1,944	12,519	5,886
Hospice	1,821	161	4,759	483
	6,474	2,105	17,278	6,369
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services	3,344	2,879	10,076	8,985
RehabCare	1,955	2,866	5,790	8,446
	5,299	5,745	15,866	17,431
Nursing center division	6,695	7,606	21,151	22,319
Support center	7,905	6,956	21,631	21,618
	$39,329	$38,748	$116,889	$117,012

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,	
	2015	2014	2015	2014
Capital expenditures, excluding acquisitions (including discontinued operations):				
Hospital division:				
Routine	$5,127	$6,470	$20,017	$23,097
Development	–	–	–	562
	5,127	6,470	20,017	23,659
Kindred at Home:				
Home health:				
Routine	1,225	214	2,336	652
Development	–	–	–	–
	1,225	214	2,336	652
Hospice:				
Routine	352	14	834	52
Development	–	–	–	–
	352	14	834	52
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services:				
Routine	350	62	625	162
Development	1,281	–	1,342	–
	1,631	62	1,967	162
RehabCare:				
Routine	532	489	1,248	1,931
Development	–	–	–	–
	532	489	1,248	1,931
Nursing center division:				
Routine	4,738	5,024	14,146	15,242
Development	2,085	1,570	8,330	2,131
	6,823	6,594	22,476	17,373
Support center:				
Routine:				
Information systems	22,765	8,593	40,335	25,560
Other	333	397	1,150	729
Development	2,394	–	2,394	–
	25,492	8,990	43,879	26,289
Totals:				

Routine	35,422	21,263	80,691	67,425
Development	5,760	1,570	12,066	2,693
	$41,182	$22,833	$92,757	$70,118

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 7 – BUSINESS SEGMENT DATA (Continued)

	September 30, 2015	December 31, 2014
Assets at end of period:		
Hospital division	$1,687,728	$ 1,751,695
Kindred at Home:		
Home health	1,424,600	203,154
Hospice	899,937	32,733
	2,324,537	235,887
Kindred Rehabilitation Services:		
Kindred Hospital Rehabilitation Services	787,464	366,153
RehabCare	377,130	360,860
	1,164,594	727,013
Nursing center division	496,828	513,603
Support center	830,309	2,424,766
	$6,503,996	$ 5,652,964
Goodwill:		
Hospital division	$628,519	$ 679,480
Kindred at Home:		
Home health	901,527	117,589
Hospice	630,439	26,910
	1,531,966	144,499
Kindred Rehabilitation Services:		
Kindred Hospital Rehabilitation Services	486,281	173,618
RehabCare	–	–
	486,281	173,618
	$2,646,766	$ 997,597

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 subsidiaries. Provisions for loss for these risks are based upon management's best available information including actuarially determined estimates. Effective with the Gentiva Merger, the Company cancelled all policies issued by the Gentiva wholly owned limited purpose insurance subsidiary and insures all post-merger risks through its insurance subsidiary.

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 risks 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,	
	2015	2014	2015	2014
Professional liability:				
Continuing operations	$ 19,778	$ 14,656	$ 51,067	$ 43,828
Discontinued operations	(1,741)	(37)	(2,408)	8,969
Workers compensation:				
Continuing operations	$ 11,165	$ 9,939	$ 40,021	$ 27,394
Discontinued operations	(2,219)	366	(2,225)	1,811

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, 2015			December 31, 2014		
	Professional liability	Workers compensation	Total	Professional liability	Workers compensation	Total
Assets:						
Current:						
Insurance subsidiary investments	$59,250	$ 44,606	$103,856	$63,183	$ 36,768	$99,951
Reinsurance recoverables	5,496	–	5,496	7,376	–	7,376
Other	–	100	100	–	100	100
	64,746	44,706	109,452	70,559	36,868	107,427
Non-current:						
Insurance subsidiary investments	90,989	110,037	201,026	84,210	81,835	166,045
Reinsurance and other recoverables	95,994	87,072	183,066	81,722	73,714	155,436
Deposits	3,980	3,784	7,764	3,879	1,428	5,307
Other	–	38	38	–	38	38
	190,963	200,931	391,894	169,811	157,015	326,826
	$255,709	$ 245,637	$501,346	$240,370	$ 193,883	$434,253
Liabilities:						
Allowance for insurance risks:						
Current	$62,020	$ 49,017	$111,037	$64,137	$ 39,802	$103,939
Non-current	273,874	209,330	483,204	243,614	149,457	393,071
	$335,894	$ 258,347	$594,241	$307,751	$ 189,259	$497,010

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 2015 and 2014 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 $338.4 million at September 30, 2015 and $310.3 million at December 31, 2014.

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.

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.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 9 – INSURANCE SUBSIDIARY INVESTMENTS (Continued)

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, 2015				December 31, 2014			
	Cost	Unrealized gains	Unrealized losses	Fair value	Cost	Unrealized gains	Unrealized losses	Fair value
Cash and cash equivalents (a)	$182,154	$ –	$ –	$182,154	$150,556	$ –	$ –	$150,556
Debt securities:								
Corporate bonds	46,811	38	(43)	46,806	49,077	19	(60)	49,036
Debt securities issued by U.S. government agencies	24,809	68	–	24,877	25,313	19	(19)	25,313
U.S. Treasury notes	29,436	29	–	29,465	25,813	3	(7)	25,809
	101,056	135	(43)	101,148	100,203	41	(86)	100,158
Equities by industry:								
Consumer	2,865	297	(58)	3,104	1,539	107	(13)	1,633
Financial services	2,093	76	(103)	2,066	975	56	(6)	1,025
Technology	2,086	95	(121)	2,060	989	41	(34)	996
Healthcare	1,758	45	(127)	1,676	962	60	(8)	1,014
Industrials	1,344	–	(138)	1,206	649	14	(22)	641
Other	5,540	–	(974)	4,566	3,145	40	(265)	2,920
	15,686	513	(1,521)	14,678	8,259	318	(348)	8,229
Certificates of deposit	6,900	3	(1)	6,902	7,051	2	–	7,053
	$305,796	$ 651	$ (1,565)	$304,882	$266,069	$ 361	$ (434)	$265,996

(a) Includes $31.1 million and $15.6 million of money market funds at September 30, 2015 and December 31, 2014, respectively.

Since the Company's insurance subsidiary investments are restricted for a limited purpose, they are classified in the accompanying unaudited condensed consolidated balance sheet based upon the expected current and long-term cash requirements of the Company's limited purpose insurance subsidiaries.

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, 2015 and 2014 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.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 10 – LONG-TERM DEBT

Capitalization

A summary of long-term debt follows (in thousands):

	September 30, 2015	December 31, 2014
Term Loan Facility, net of unamortized original issue discount (“OID”) of $6.5 million at September 30, 2015 and $6.4 million at December 31, 2014	$1,179,496	$988,645
8.00% Notes due 2020	750,000	750,000
8.75% Notes due 2023	600,000	600,000
6.375% Notes due 2022	500,000	500,000
ABL Facility	95,000	–
Mandatory Redeemable Preferred Stock (See Note 11)	26,638	34,773
Capital lease obligations	915	–
Other	6,837	3,720
Total debt, average life of 6 years (weighted average rate 6.4% for 2015 and 6.7% for 2014)	3,158,886	2,877,138
Amounts due within one year	(32,527)	(24,607)
Long-term debt	$3,126,359	$2,852,531

Gentiva Merger – Financing Transactions

The following transactions (collectively, the “Financing Transactions”) occurred in connection with the Gentiva Merger:

• the Company issued $1.35 billion aggregate principal amount of senior notes;

• the Company issued approximately 15 million shares of its common stock through two common stock offerings (see Note 11) and issued 9.7 million shares of its common stock through the Stock Consideration (see Note 2);

• the Company issued 172,500 tangible equity units (the “Units”) (see Note 11); and

• the Company amended its credit facilities.

Notes Offering

On December 18, 2014, Kindred Escrow Corp. II (the “Escrow Issuer”), one of the Company’s subsidiaries, completed a private placement of $750 million aggregate principal amount of 8.00% Senior Notes due 2020 (the “Notes due 2020”) and $600 million aggregate principal amount of 8.75% Senior Notes due 2023 (the “Notes due 2023”) (the Notes due 2020 and the Notes due 2023 are collectively referred to as the “Notes”). The Notes due 2020 were issued pursuant to the indenture, dated as of December 18, 2014 (the “2020 Indenture”), between the Escrow Issuer and Wells Fargo Bank, National Association, as trustee. The Notes due 2023 were issued pursuant to the indenture, dated as of December 18, 2014 (the “2023 Indenture” and, together with the 2020 Indenture, the “Indentures”), between the Escrow Issuer and Wells Fargo Bank, National Association.

Prior to the consummation of the Gentiva Merger, the Notes were senior secured obligations of the Escrow Issuer. Upon consummation of the Gentiva Merger, the Escrow Issuer was merged with and into the Company, as a result of which the Notes were assumed by the Company and fully and unconditionally guaranteed on a senior unsecured basis by substantially all of the Company’s domestic 100% owned subsidiaries, including substantially all of the Company’s and Gentiva’s domestic 100% owned subsidiaries (the “Guarantors”), ranking pari passu with all of the Company’s respective existing and future senior unsubordinated indebtedness.

The Indentures contain certain restrictive covenants that limit the Company and its restricted subsidiaries’ ability to, among other things, incur, assume or guarantee additional indebtedness; pay dividends, make distributions or redeem or repurchase capital stock; effect dividends, loans or asset transfers from its subsidiaries; sell or otherwise dispose of assets; and enter into transactions with affiliates. These covenants are subject to a number of limitations and exceptions. The Indentures also contain customary events of default.

Under the terms of the Indentures, the Company may pay dividends pursuant to specified exceptions or, if its consolidated coverage ratio (as defined therein) is at least 2.0 to 1.0, it may also pay dividends in an amount equal to 50% of its consolidated net income (as defined therein) and 100% of the net cash proceeds from the issuance of capital stock, in each case since January 1, 2014. The making of certain other restricted payments or investments by the Company or its restricted subsidiaries would reduce the amount available for the payment of dividends pursuant to the foregoing exception.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 10 – LONG-TERM DEBT (Continued)

Registration Rights Agreements – Notes due 2020 and Notes due 2023

On December 18, 2014, the Escrow Issuer entered into a registration rights agreement related to each of the Notes (the "Registration Rights Agreements"), each with Citigroup Global Markets Inc., as representative of the initial purchasers of the Notes. After the consummation of the Gentiva Merger, the Company and each of the Guarantors executed a joinder agreement to become parties to the Registration Rights Agreements.

Pursuant to the Registration Rights Agreements, the Company and the Guarantors agreed (among other obligations) to use commercially reasonable efforts to file with the SEC a registration statement relating to an offer to exchange each of the Notes due 2020 and the Notes due 2023 for registered notes with substantially identical terms and consummate such offer within 365 days after the issuance of the Notes. The Company commenced an exchange offer on September 29, 2015, which expired on October 28, 2015. The Company completed the registered exchange offer on October 30, 2015.

Escrow Agreements

On December 18, 2014, the Company and the Escrow Issuer entered into an escrow agreement related to each of the Notes (the "Escrow Agreements"), each with Wells Fargo Bank, National Association, as trustee under the Indentures, and as escrow agent. Pursuant to the Escrow Agreements, the Escrow Issuer deposited the gross proceeds of $1.35 billion from the sale of the Notes into the separate escrow accounts (the "Escrow Accounts") and the Company deposited an additional amount sufficient (together with the gross proceeds deposited by the Escrow Issuer) to fund the redemption of the Notes and to pay all regularly scheduled interest on the Notes to, but not including, the special mandatory redemption date into the respective Escrow Accounts. The amount of interest deposited on December 18, 2014 totaled $23.4 million. The amounts in the Escrow Accounts were released upon consummation of the Gentiva Merger. The release of the escrowed funds was conditioned on the consummation of the Gentiva Merger, the merger of the Escrow Issuer with and into the Company, as a result of which the Company assumed the Escrow Issuer's obligations under the Notes, and other conditions set forth in the Escrow Agreements.

Credit Facilities Amendments

On November 25, 2014, the Company entered into a fourth amendment and restatement agreement (the "Term Loan Amendment Agreement") among the Company, the consenting lenders party thereto and JPMorgan Chase Bank, N.A., as administrative agent. The Term Loan Amendment Agreement amended and restated the Term Loan Credit Agreement dated as of June 1, 2011, as amended by that certain Incremental Amendment No. 1 to the Term Loan Credit Agreement dated as of October 4, 2012 and as further amended and restated by that certain Amendment and Restatement Agreement dated as of May 30, 2013, that certain Second Amendment and Restatement Agreement dated as of August 21, 2013 and that certain Third Amendment and Restatement Agreement dated as of April 9, 2014, among the Company, the lenders party thereto and JPMorgan Chase Bank, N.A., as administrative agent and collateral agent (the "Term Loan Facility").

The Term Loan Amendment Agreement amended and restated the Term Loan Facility to, among other items, (i) modify certain provisions related to the issuance of Notes into the Escrow Accounts, (ii) increase the applicable interest rate margins for LIBOR borrowings from 3.00% to 3.25% and for base rate borrowings from 2.00% to 2.25%, (iii) temporarily increase the maximum total leverage ratio permitted under the financial maintenance covenants, (iv) include soft-call protection at a prepayment premium of 1.00% for twelve months starting from November 25, 2014 and (v) modify certain provisions related to the incurrence of debt and the making of acquisitions, investments and restricted payments. The Term Loan Amendment Agreement did not modify the maturity date of the loans made thereunder.

On March 10, 2015, the Company entered into an incremental amendment agreement, which provided for an incremental term loan in an aggregate principal amount of $200 million under its Term Loan Facility. The Company used the net proceeds of the incremental term loan to repay outstanding borrowings under its $900 million ABL Facility (as defined below). The incremental term loan was issued with 50 basis points of OID and has the same terms as, and is fungible with, all other term loans outstanding under the Company’s Term Loan Facility.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 10 – LONG-TERM DEBT (Continued)

Credit Facilities Amendments (Continued)

On October 31, 2014, the Company entered into a third amendment and restatement agreement (the “ABL Amendment Agreement”) among the Company, the consenting lenders party thereto and JPMorgan Chase Bank, N.A., as administrative agent. The ABL Amendment Agreement amended and restated the ABL Credit Agreement dated as of June 1, 2011, as amended by that certain Amendment No. 1 to the ABL Credit Agreement dated as of October 4, 2012 and as further amended and restated by that certain Amendment and Restatement Agreement dated as of August 21, 2013 and that certain Second Amendment and Restatement Agreement dated as of April 9, 2014 (the “ABL Facility”), among the Company, the lenders from time to time party thereto and JPMorgan Chase Bank, N.A., as administrative agent and collateral agent.

The ABL Amendment Agreement, among other items, modified certain provisions related to the issuance of Notes into the Escrow Accounts. Upon the consummation of the Gentiva Merger and the satisfaction of certain other conditions, the ABL Amendment Agreement further amended and restated the ABL Facility to, among other items, modify certain provisions related to the incurrence of debt and the making of acquisitions, investments and restricted payments. The ABL Amendment Agreement did not modify the maturity date of the revolving commitments thereunder or the applicable interest rate margins applicable to any borrowings thereunder.

In addition, on December 12, 2014, the Company entered into an incremental joinder agreement (the “Incremental ABL Joinder”) among the Company, JPMorgan Chase Bank, N.A., as administrative agent and collateral agent, the incremental lenders party thereto and the other credit parties party thereto. Upon the consummation of the Gentiva Merger and the satisfaction of certain other conditions, the Incremental ABL Joinder provided for additional revolving commitments in an aggregate principal amount of $150 million under the ABL Facility.

All obligations under the ABL Facility and the Term Loan Facility 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 due 2022 (as defined below), the Notes due 2020 and the Notes due 2023 are fully and unconditionally guaranteed, subject to certain customary release provisions, by substantially all of the Company’s domestic 100% owned subsidiaries.

Amendment to Notes due 2022

On April 9, 2014, the Company completed a private placement of $500 million aggregate principal amount of 6.375% senior notes due 2022 (the “Notes due 2022”). The Notes due 2022 were issued pursuant to the indenture dated April 9, 2014 (the “2022 Indenture”) among the Company, the guarantors party thereto (the “2022 Guarantors”) and Wells Fargo Bank, National Association, as trustee.

On January 30, 2015, following the receipt of sufficient consents to approve the proposed amendments (the “Amendments”), the Company, the 2022 Guarantors and Wells Fargo Bank, National Association, as trustee, entered into the first supplemental indenture (the “2022 Notes Supplemental Indenture”) to the 2022 Indenture. The 2022 Notes

Supplemental Indenture conforms certain covenants, definitions and other terms in the 2022 Indenture to the covenants, definitions and terms contained in the Indentures governing the Notes. The Amendments became operative following the consummation of the Gentiva Merger.

April 2014 Debt Refinancing

On April 9, 2014, the Company completed the refinancing of substantially all of its then existing debt and incurred the following costs during the nine months ended September 30, 2014:

- Unamortized deferred financing costs related to the Company's prior ABL facility totaling $0.6 million ($0.4 million net of income taxes) were written-off and recorded as interest expense.
- Unamortized deferred financing costs and OID related to the Company's Prior Term Loan Facility totaling $5.0 million ($3.1 million net of income taxes) were written-off and recorded as interest expense.
- Unamortized deferred financing costs totaling $10.7 million ($6.6 million net of income taxes), the applicable premium totaling $36.4 million ($22.5 million net of income taxes) and interest expense for the period from April 9, 2014 to May 9, 2014 totaling $3.9 million ($2.4 million net of income taxes), all related to the Company's prior $550 million, 8.25% senior notes due 2019, were written-off and recorded as interest expense.

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 11 – CAPITAL STOCK

Gentiva Merger

In connection with the Gentiva Merger, Kindred issued 9.7 million shares of common stock as part of the Stock Consideration (see Note 2).

Common Stock Offerings

On November 25, 2014, in an offering registered with the SEC, the Company completed the sale of 5,000,000 shares of its common stock for cash and granted the underwriters a 30-day over-allotment option to purchase up to an additional 750,000 shares of common stock. On December 1, 2014, the underwriters exercised their over-allotment option to purchase 395,759 additional shares of common stock, which the Company closed on December 3, 2014. The Company refers to this offering and sale of its common stock herein as the “November Common Stock Offering.” The net proceeds of the November Common Stock Offering, after deducting the underwriting discount and offering expenses, were $101.0 million.

On June 25, 2014, in an offering registered with the SEC, the Company completed the sale of 9,000,000 shares of its common stock for cash and granted the underwriters a 30-day option to purchase up to an additional 1,350,000 shares of common stock, of which 723,468 shares were purchased on July 14, 2014. The Company refers to this offering and the sale of its common stock herein as the “June Common Stock Offering.” The net proceeds of the June Common Stock Offering, after deducting the underwriting discount and offering expenses, were $220.4 million.

Units Offering

On November 25, 2014, in an offering registered with the SEC, the Company completed the sale of 150,000 Units for cash and granted the underwriters a 13-day over-allotment option to purchase up to an additional 22,500 Units. On December 1, 2014, the underwriters exercised in full their over-allotment option to purchase 22,500 additional Units, which the Company closed on December 3, 2014. Each Unit is composed of a prepaid stock purchase contract (a “Purchase Contract”) and one share of 7.25% Mandatory Redeemable Preferred Stock, Series A (the “Mandatory Redeemable Preferred Stock”), having a final preferred stock installment payment date of December 1, 2017 and an initial liquidation preference of $201.58 per share of Mandatory Redeemable Preferred Stock. The net proceeds from the offering of the Units, after deducting the underwriting discount and offering expenses, were $166.3 million. The Purchase Contracts were recorded as capital in excess of par value, net of issue costs, and the Mandatory Redeemable Preferred Stock has been recorded as long-term debt.

As of September 30, 2015, holders of 85,121 Purchase Contracts elected early settlement. As a result, holders thereof received 43.0918 shares of common stock per Purchase Contract, resulting in approximately 3.7 million shares of common stock being issued by the Company.

Dividends and Other Payments

During the nine months ended September 30, 2015, the Company paid a cash dividend of $0.12 per common share on September 4, 2015 to shareholders of record as of the close of business on August 19, 2015 and also paid a cash dividend of $0.12 per common share on each of June 10, 2015 and April 1, 2015 to shareholders.

During the nine months ended September 30, 2014, the Company paid a cash dividend of $0.12 per common share on September 10, 2014 to shareholders of record as of the close of business on August 20, 2014 and also paid a cash dividend of $0.12 per common share on each of June 11, 2014 and March 27, 2014 to shareholders.

The Company made an installment payment on the Company’s Units on September 1, 2015 to holders of record on August 15, 2015, and also made an installment payment on the Company’s Units on June 1, 2015, each of which consisted of a quarterly installment payment of $18.75 per Unit. The Company also made an installment payment on the Company’s Units on March 2, 2015, which consisted of a quarterly installment payment of $18.75 per Unit, plus a one-time incremental payment of $1.25 per Unit for the period between November 25, 2014 and December 1, 2014, for a total payment of $20.00 per Unit. To the extent that any Unit has been separated into its constituent Purchase Contract and its constituent share of Mandatory Redeemable Preferred Stock, the installment payment is payable only on the constituent share of Mandatory Redeemable Preferred Stock.

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 and the denial of payment by third parties to the Company's customers.

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.

Legal and regulatory proceedings – The Company is a party to various legal actions 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. 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. These matters could potentially subject the Company to sanctions, damages, recoupments, fines and other penalties (some of which may not be covered by insurance), 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. These indemnifications could potentially subject the Company to damages and other payments which may, either individually or in the aggregate, have a material adverse effect on the Company's business, financial position, results of operations or liquidity.

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.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 GAAP.

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.
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.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 13 – FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (Continued)

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 Level 1	Level 2	Level 3	Assets/liabilities at fair value	Total losses
September 30, 2015:					
Recurring:					
Assets:					
Available-for-sale debt securities:					
Corporate bonds	$–	$46,806	$–	$ 46,806	$–
Debt securities issued by U.S. government agencies	–	24,877	–	24,877	–
U.S. Treasury notes	29,465	–	–	29,465	–
	29,465	71,683	–	101,148	–
Available-for-sale equity securities	14,678	–	–	14,678	–
Money market funds	32,920	–	–	32,920	–
Certificates of deposit	–	6,902	–	6,902	–
Total available-for-sale investments	77,063	78,585	–	155,648	–
Deposits held in money market funds	13,900	3,884	–	17,784	–
	$90,963	$82,469	$–	$ 173,432	$–
Liabilities:					
Contingent consideration liability	$–	$–	$(6,608)	$ (6,608)	$–
Interest rate swaps	–	(5,846)	–	(5,846)	–
	$–	$(5,846)	$(6,608)	$ (12,454)	$–
Non-recurring:					
Assets:					
Intangible assets – trade name	$–	$–	$1,405	$ 1,405	$(6,726)
Liabilities	$–	$–	$–	$ –	$–
December 31, 2014:					
Recurring:					
Assets:					
Available-for-sale debt securities:					
Corporate bonds	$–	$49,036	$–	$ 49,036	$–
Debt securities issued by U.S. government agencies	–	25,313	–	25,313	–
U.S. Treasury notes	25,809	–	–	25,809	–
	25,809	74,349	–	100,158	–
Available-for-sale equity securities	8,229	–	–	8,229	–
Money market funds	17,787	–	–	17,787	–
Certificates of deposit	–	7,053	–	7,053	–
Total available-for-sale investments	51,825	81,402	–	133,227	–

Deposits held in money market funds	105,140	3,883	–	109,023	–
	$156,965	$85,285	$–	$ 242,250	$–
Liabilities:					
Interest rate swaps	$–	$(3,673)	$–	$ (3,673)	$–
Non-recurring:					
Assets:					
Property and equipment	$–	$–	$19	$ 19	$(673)
Liabilities	$–	$–	$–	$ –	$–

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NOTE 13 – FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (Continued)

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 $151.1 million as of September 30, 2015 and $135.0 million as of December 31, 2014, 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 $1.8 million as of September 30, 2015 and $2.2 million as of December 31, 2014 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 is based upon quoted market prices and is generally classified as Level 1. The fair value of inactively traded debt securities and certificates of deposit is 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 is 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 months or nine months ended September 30, 2015 or September 30, 2014.

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

The Company acquired a contingent consideration liability in the Gentiva Merger from a prior acquisition by Gentiva with an initial estimated fair value of $8.3 million. The fair value is determined using a discounted cash flow approach utilizing Level 2 and Level 3 inputs which includes observable market discount rates, fixed payment schedules, and assumptions based on achieving certain predefined performance criteria. As of September 30, 2015, the fair value of the Level 3 contingent consideration liability was $6.6 million. The change in fair value in the third quarter of 2015 consists of $0.1 million in fixed payments and $0.1 million in accrued interest included in interest expense in the accompanying unaudited condensed consolidated statement of operations. A one percent change in the discount rate used to calculate the accretion of the present value of the contingent consideration liability would have an impact on the fair value of approximately $0.1 million.

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.

(In thousands)	September 30, 2015 Carrying value	Fair value	December 31, 2014 Carrying value	Fair value
Cash and cash equivalents	$120,891	$120,891	$164,188	$164,188
Insurance subsidiary investments	304,882	304,882	265,996	265,996
Long-term debt, including amounts due within one year (excluding capital lease obligations totaling $0.9 million at September 30, 2015)	3,157,971	3,236,887	2,877,138	2,930,815

Non-recurring measurements

During the nine months ended September 30, 2015, the Company recorded an asset impairment charge of $6.7 million related to previously acquired home health and hospice trade names after the decision in the first quarter of 2015 to rebrand to the Kindred at Home trade name. These charges reflect the amount by which the carrying value exceeded its estimated fair value. The fair value of the trade names was measured using Level 3 unobservable inputs, primarily economic obsolescence.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION

The accompanying 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 Notes due 2020, Notes due 2022 and Notes due 2023 are all fully and unconditionally guaranteed by the Company's domestic 100% owned subsidiaries. The Company's Notes due 2020 and the Notes due 2023, which were issued during 2014, were senior unsecured obligations of the Escrow Issuer, which, prior to the Gentiva Merger, was a non-guarantor subsidiary of the Company. In connection with the Gentiva Merger, the Escrow Issuer was merged with and into the Company, with the Company assuming the Notes due 2020 and Notes due 2023. See Note 10. 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, 2015 and December 31, 2014, and the respective results of operations and cash flows for the three months and nine months ended September 30, 2015 and September 30, 2014.

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

	Three months ended September 30, 2015				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$–	$ 1,553,814	$ 236,783	$ (26,081)	$ 1,764,516
Salaries, wages and benefits	–	869,689	52,451	–	922,140
Supplies	–	83,840	12,711	–	96,551
Rent	–	77,083	19,161	–	96,244
Other operating expenses	–	186,036	21,801	–	207,837
General and administrative expenses	–	228,943	107,179	(26,081)	310,041
Other (income) expense	–	35	(685)	–	(650)
Litigation contingency expense	–	31,462	–	–	31,462
Depreciation and amortization	–	36,920	2,409	–	39,329
Management fees	–	(5,170)	5,170	–	–
Intercompany interest (income) expense from affiliates	(51,099)	39,769	11,330	–	–
Interest expense	56,350	27	63	–	56,440
Investment income	–	(177)	(255)	–	(432)
Equity in net loss of consolidating affiliates	11,415	–	–	(11,415)	–
	16,666	1,548,457	231,335	(37,496)	1,758,962
	(16,666)	5,357	5,448	11,415	5,554

Income (loss) from continuing operations before income taxes					
Provision (benefit) for income taxes	(2,067)	14,411	179	–	12,523
Income (loss) from continuing operations	(14,599)	(9,054)	5,269	11,415	(6,969)
Income (loss) from discontinued operations, net of income taxes	–	2,311	(42)	–	2,269
Net income (loss)	(14,599)	(6,743)	5,227	11,415	(4,700)
(Earnings) loss attributable to noncontrolling interests:					
Continuing operations	–	–	(9,900)	–	(9,900)
Discontinued operations	–	–	1	–	1
	–	–	(9,899)	–	(9,899)
Loss attributable to Kindred	$(14,599)	$(6,743)	$ (4,672)	$ 11,415	$(14,599)
Comprehensive income (loss)	$(15,716)	$(6,743)	$ 4,591	$ 12,051	$(5,817)
Comprehensive loss attributable to Kindred	$(15,716)	$(6,743)	$ (5,308)	$ 12,051	$(15,716)

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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 Operations and Comprehensive Income (Loss) (Continued)

	Three months ended September 30, 2014				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$–	$1,095,351	$ 159,377	$ (25,810)	$1,228,918
Salaries, wages and benefits	–	570,624	31,189	–	601,813
Supplies	–	63,238	7,481	–	70,719
Rent	–	65,686	11,957	–	77,643
Other operating expenses	–	175,344	20,048	(25,810)	169,582
General and administrative expenses	–	159,143	78,360	–	237,503
Other (income) expense	–	29	(289)	–	(260)
Depreciation and amortization	–	36,618	2,130	–	38,748
Management fees	–	(2,940)	2,940	–	–
Intercompany interest (income) expense from affiliates	(28,895)	19,974	8,921	–	–
Interest expense	22,461	9	45	–	22,515
Investment income	–	(122)	(222)	–	(344)
Equity in net loss of consolidating affiliates	8,263	–	–	(8,263)	–
	1,829	1,087,603	162,560	(34,073)	1,217,919
Income (loss) from continuing operations before income taxes	(1,829)	7,748	(3,183)	8,263	10,999
Provision (benefit) for income taxes	2,533	1,423	(179)	–	3,777
Income (loss) from continuing operations	(4,362)	6,325	(3,004)	8,263	7,222
Discontinued operations, net of income taxes:					
Loss from operations	–	(6,639)	(2,038)	–	(8,677)
Gain on divestiture of operations	–	1,350	37	–	1,387
Loss from discontinued operations	–	(5,289)	(2,001)	–	(7,290)
Net income (loss)	(4,362)	1,036	(5,005)	8,263	(68)
(Earnings) loss attributable to noncontrolling interests:					
Continuing operations	–	–	(4,372)	–	(4,372)
Discontinued operations	–	–	78	–	78
	–	–	(4,294)	–	(4,294)
Income (loss) attributable to Kindred	$(4,362)	$1,036	$ (9,299)	$ 8,263	$(4,362)
Comprehensive income (loss)	$(2,968)	$1,036	$ (4,934)	$ 8,192	$1,326
	$(2,968)	$1,036	$ (9,228)	$ 8,192	$(2,968)

Comprehensive income (loss) attributable to Kindred

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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 Operations and Comprehensive Income (Loss) (Continued)

	Nine months ended September 30, 2015				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$–	$4,626,164	$ 724,586	$ (76,792)	$ 5,273,958
Salaries, wages and benefits	–	2,534,133	170,787	–	2,704,920
Supplies	–	249,995	38,064	–	288,059
Rent	–	228,248	56,538	–	284,786
Other operating expenses	–	542,682	74,999	–	617,681
General and administrative expenses	–	822,795	304,945	(76,792)	1,050,948
Other (income) expense	–	355	(2,054)	–	(1,699)
Litigation contingency expense	–	130,387	–	–	130,387
Impairment charges	–	6,726	–	–	6,726
Depreciation and amortization	–	109,571	7,318	–	116,889
Management fees	–	(14,766)	14,766	–	–
Intercompany interest (income) expense from affiliates	(154,140)	120,173	33,967	–	–
Interest expense	172,534	3,371	223	–	176,128
Investment income	–	(1,525)	(678)	–	(2,203)
Equity in net loss of consolidating affiliates	127,902	–	–	(127,902)	–
	146,296	4,732,145	698,875	(204,694)	5,372,622
Income (loss) from continuing operations before income taxes	(146,296)	(105,981)	25,711	127,902	(98,664)
Provision (benefit) for income taxes	(7,238)	15,956	465	–	9,183
Income (loss) from continuing operations	(139,058)	(121,937)	25,246	127,902	(107,847)
Discontinued operations, net of income taxes:					
Loss from operations	–	(793)	(951)	–	(1,744)
Gain on divestiture of operations	–	983	–	–	983
Income (loss) from discontinued operations	–	190	(951)	–	(761)
Net income (loss)	(139,058)	(121,747)	24,295	127,902	(108,608)
(Earnings) loss attributable to noncontrolling interests:					
Continuing operations	–	–	(30,482)	–	(30,482)
Discontinued operations	–	–	32	–	32
	–	–	(30,450)	–	(30,450)
Loss attributable to Kindred	$(139,058)	$(121,747)	$ (6,155)	$ 127,902	$(139,058)

Comprehensive income (loss)	$(140,835)	$(121,747)	$ 23,748	$ 128,449	$(110,385)
Comprehensive loss attributable to Kindred	$(140,835)	$(121,747)	$ (6,702)	$ 128,449	$(140,835)

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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 Operations and Comprehensive Income (Loss) (Continued)

	Nine months ended September 30, 2014				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$–	$3,344,987	$ 495,368	$ (77,430)	$3,762,925
Salaries, wages and benefits	–	1,730,053	96,549	–	1,826,602
Supplies	–	191,760	23,509	–	215,269
Rent	–	197,825	36,047	–	233,872
Other operating expenses	–	527,426	61,790	(77,430)	511,786
General and administrative expenses	–	479,034	234,487	–	713,521
Other (income) expense	–	351	(945)	–	(594)
Litigation contingency expense	–	4,600	–	–	4,600
Depreciation and amortization	–	110,580	6,432	–	117,012
Management fees	–	(10,186)	10,186	–	–
Intercompany interest (income) expense from affiliates	(85,594)	58,361	27,233	–	–
Interest expense	128,688	20	136	–	128,844
Investment income	–	(427)	(2,548)	–	(2,975)
Equity in net loss of consolidating affiliates	6,018	–	–	(6,018)	–
	49,112	3,289,397	492,876	(83,448)	3,747,937
Income (loss) from continuing operations before income taxes	(49,112)	55,590	2,492	6,018	14,988
Provision (benefit) for income taxes	(16,959)	21,501	747	–	5,289
Income (loss) from continuing operations	(32,153)	34,089	1,745	6,018	9,699
Discontinued operations, net of income taxes:					
Loss from operations	–	(19,756)	(5,131)	–	(24,887)
Loss on divestiture of operations	–	(1,999)	(1,638)	–	(3,637)
Loss from discontinued operations	–	(21,755)	(6,769)	–	(28,524)
Net income (loss)	(32,153)	12,334	(5,024)	6,018	(18,825)
(Earnings) loss attributable to noncontrolling interests:					
Continuing operations	–	–	(13,729)	–	(13,729)
Discontinued operations	–	–	401	–	401
	–	–	(13,328)	–	(13,328)
Income (loss) attributable to Kindred	$(32,153)	$12,334	$ (18,352)	$ 6,018	$(32,153)
Comprehensive income (loss)	$(32,806)	$12,334	$ (6,033)	$ 7,027	$(19,478)

Comprehensive income (loss) attributable to Kindred	$(32,806)	$12,334	$ (19,361)	$ 7,027	$(32,806)

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Balance Sheet

(In thousands)	As of September 30, 2015 Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$–	$44,802	$ 76,089	$–	$ 120,891
Insurance subsidiary investments	–	–	103,856	–	103,856
Accounts receivable, net	–	1,077,987	138,227	–	1,216,214
Inventories	–	22,923	4,329	–	27,252
Deferred tax assets	–	74,221	–	–	74,221
Income taxes	–	9,567	1,004	–	10,571
Other	–	37,601	29,290	–	66,891
	–	1,267,101	352,795	–	1,619,896
Property and equipment, net	–	899,166	56,674	–	955,840
Goodwill	–	2,085,783	560,983	–	2,646,766
Intangible assets, net	–	735,299	48,475	–	783,774
Assets held for sale	–	1,526	–	–	1,526
Insurance subsidiary investments	–	–	201,026	–	201,026
Intercompany	4,725,150	–	–	(4,725,150)	–
Deferred tax assets	–	–	7,407	(7,407)	–
Other	65,389	123,906	105,873	–	295,168
	$4,790,539	$5,112,781	$ 1,333,233	$(4,732,557)	$6,503,996
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$–	$109,458	$ 72,696	$–	$ 182,154
Salaries, wages and other compensation	–	385,563	57,167	–	442,730
Due to third party payors	–	59,498	–	–	59,498
Professional liability risks	–	5,624	56,396	–	62,020
Other accrued liabilities	56,429	267,926	21,954	–	346,309
Long-term debt due within one year	26,322	–	6,205	–	32,527
	82,751	828,069	214,418	–	1,125,238
Long-term debt	3,124,812	–	1,547	–	3,126,359
Intercompany/deficiency in earnings of consolidated subsidiaries	126,506	4,137,757	587,393	(4,851,656)	–
Professional liability risks	–	61,177	212,697	–	273,874

Deferred tax liabilities	–	28,257	–	(7,407)	20,850
Deferred credits and other liabilities	–	168,957	138,207	–	307,164
Commitments and contingencies					
Equity (deficit):					
Stockholders' equity (deficit)	1,456,470	(111,436)	(15,070)	126,506	1,456,470
Noncontrolling interests	–	–	194,041	–	194,041
	1,456,470	(111,436)	178,971	126,506	1,650,511
	$4,790,539	$5,112,781	$ 1,333,233	$ (4,732,557)	$ 6,503,996

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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, 2014				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$–	$ 129,408	$ 34,780	$ –	$ 164,188
Insurance subsidiary investments	–	–	99,951	–	99,951
Accounts receivable, net	–	852,007	92,212	–	944,219
Inventories	–	22,908	2,794	–	25,702
Deferred tax assets	–	82,391	–	–	82,391
Income taxes	–	7,621	954	–	8,575
Interest deposit on senior unsecured notes held in escrow	–	–	23,438	–	23,438
Other	–	37,639	3,959	–	41,598
	–	1,131,974	258,088	–	1,390,062
Property and equipment, net	–	859,414	42,690	–	902,104
Goodwill	–	704,790	292,807	–	997,597
Intangible assets, net	–	377,710	22,990	–	400,700
Assets held for sale	–	3,475	–	–	3,475
Insurance subsidiary investments	–	–	166,045	–	166,045
Investment in subsidiaries	1,943	–	–	(1,943)	–
Intercompany	2,937,529	–	–	(2,937,529)	–
Deferred tax assets	–	4,062	7,112	–	11,174
Proceeds from senior unsecured notes held in escrow	–	–	1,350,000	–	1,350,000
Acquisition deposit	–	195,000	–	–	195,000
Other	46,130	104,463	86,214	–	236,807
	$2,985,602	$3,380,888	$ 2,225,946	$ (2,939,472)	$ 5,652,964
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$–	$ 126,173	$ 49,552	$ –	$ 175,725
Salaries, wages and other compensation	–	311,271	47,586	–	358,857
Due to third party payors	–	43,957	–	–	43,957
Professional liability risks	–	3,323	60,814	–	64,137
Other accrued liabilities	20,317	157,169	12,494	–	189,980

Long-term debt due within one year	20,887	–	3,720	–	24,607
	41,204	641,893	174,166	–	857,263
Long-term debt	1,502,531	–	1,350,000	–	2,852,531
Intercompany	–	2,539,697	397,832	(2,937,529)	–
Professional liability risks	–	55,634	187,980	–	243,614
Deferred credits and other liabilities	–	133,353	80,231	–	213,584
Commitments and contingencies					
Equity:					
Stockholders' equity (deficit)	1,441,867	10,311	(8,368)	(1,943)	1,441,867
Noncontrolling interests	–	–	44,105	–	44,105
	1,441,867	10,311	35,737	(1,943)	1,485,972
	$2,985,602	$3,380,888	$ 2,225,946	$(2,939,472)	$5,652,964

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, 2015				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by (used in) operating activities	$(28,117)	$137,155	$23,252	$ –	$132,290
Cash flows from investing activities:					
Routine capital expenditures	–	(32,663)	(2,759)	–	(35,422)
Development capital expenditures	–	(5,760)	–	–	(5,760)
Acquisitions, net of cash acquired	–	(1,577)	(425)	–	(2,002)
Sale of assets	–	3,884	–	–	3,884
Purchase of insurance subsidiary investments	–	–	(16,357)	–	(16,357)
Sale of insurance subsidiary investments	–	–	15,987	–	15,987
Net change in insurance subsidiary cash and cash equivalents	–	–	(2,633)	–	(2,633)
Proceeds from note receivable	–	25,000	–	–	25,000
Change in other investments	–	176	–	–	176
Other	–	1,383	–	–	1,383
Net cash used in investing activities	–	(9,557)	(6,187)	–	(15,744)
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	259,700	–	–	–	259,700
Repayment of borrowings under revolving credit	(349,700)	–	–	–	(349,700)
Repayment of term loan	(3,003)	–	–	–	(3,003)
Repayment of other long-term debt	–	–	(500)	–	(500)
Payment of deferred financing costs	(301)	–	–	–	(301)
Issuance of common stock in connection with employee benefit plans	329	–	–	–	329
Payment of dividend for Mandatory Redeemable Preferred Stock	(2,703)	–	–	–	(2,703)
Dividends paid	(10,065)	–	–	–	(10,065)
Contributions made by noncontrolling interests	–	–	1,492	–	1,492
Distributions to noncontrolling interests	–	–	(10,685)	–	(10,685)
Other	–	245	–	–	245

Net change in intercompany accounts	133,860	(136,275)	2,415	–	–
Net cash provided by (used in) financing activities	28,117	(136,030)	(7,278)	–	(115,191)
Change in cash and cash equivalents	–	(8,432)	9,787	–	1,355
Cash and cash equivalents at beginning of period	–	53,234	66,302	–	119,536
Cash and cash equivalents at end of period	$–	$ 44,802	$ 76,089	$ –	$ 120,891

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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)

	Three months ended September 30, 2014				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by operating activities	$ 12,921	$ 54,966	$ 22,152	$ –	$ 90,039
Cash flows from investing activities:					
Routine capital expenditures	–	(20,123)	(1,140)	–	(21,263)
Development capital expenditures	–	(1,570)	–	–	(1,570)
Acquisitions, net of cash acquired	–	(38)	–	–	(38)
Sale of assets	–	8,948	–	–	8,948
Purchase of insurance subsidiary investments	–	–	(74,101)	–	(74,101)
Sale of insurance subsidiary investments	–	–	8,447	–	8,447
Net change in insurance subsidiary cash and cash equivalents	–	–	65,928	–	65,928
Change in other investments	–	317	–	–	317
Other	–	(3)	–	–	(3)
Net cash used in investing activities	–	(12,469)	(866)	–	(13,335)
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	311,500	–	–	–	311,500
Repayment of borrowings under revolving credit	(355,100)	–	–	–	(355,100)
Repayment of term loan	(2,500)	–	–	–	(2,500)
Repayment of other long-term debt	–	(1)	(57)	–	(58)
Payment of deferred financing costs	(504)	–	–	–	(504)
Equity offering, net of offering costs	16,376	–	–	–	16,376
Issuance of common stock in connection with employee benefit plans	1,530	–	–	–	1,530
Dividends paid	(7,754)	–	–	–	(7,754)
Distributions to noncontrolling interests	–	–	(4,009)	–	(4,009)
Other	–	183	–	–	183
Net change in intercompany accounts	23,531	(18,040)	(5,491)	–	–
Net cash used in financing activities	(12,921)	(17,858)	(9,557)	–	(40,336)
Change in cash and cash equivalents	–	24,639	11,729	–	36,368
Cash and cash equivalents at beginning of period	–	25,901	19,515	–	45,416
Cash and cash equivalents at end of period	$–	$ 50,540	$ 31,244	$ –	$ 81,784

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, 2015				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by operating activities	$361	$29,691	$63,015	$ –	$93,067
Cash flows from investing activities:					
Routine capital expenditures	–	(75,033)	(5,658)	–	(80,691)
Development capital expenditures	–	(12,066)	–	–	(12,066)
Acquisitions, net of cash acquired	–	(501,875)	(161,882)	–	(663,757)
Acquisition deposit	–	195,000	–	–	195,000
Sale of assets	–	7,061	–	–	7,061
Proceeds from senior unsecured notes offering held in escrow	–	–	1,350,000	–	1,350,000
Interest in escrow for senior unsecured notes	–	–	23,438	–	23,438
Purchase of insurance subsidiary investments	–	–	(59,186)	–	(59,186)
Sale of insurance subsidiary investments	–	–	50,780	–	50,780
Net change in insurance subsidiary cash and cash equivalents	–	–	(8,396)	–	(8,396)
Proceeds from note receivable	–	25,000	–	–	25,000
Change in other investments	–	375	–	–	375
Other	–	590	–	–	590
Net cash provided by (used in) investing activities	–	(360,948)	1,189,096	–	828,148
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	1,414,850	–	–	–	1,414,850
Repayment of borrowings under revolving credit	(1,319,850)	–	–	–	(1,319,850)
Proceeds from issuance of term loan, net of discount	199,000	–	–	–	199,000
Proceeds from issuance of senior unsecured notes due 2020 and 2023	1,350,000	–	(1,350,000)	–	–
Repayment of Gentiva debt	–	(1,177,363)	–	–	(1,177,363)
Repayment of term loan	(9,008)	–	–	–	(9,008)

Repayment of other long-term debt	–	–	(1,400)	–	(1,400)
Payment of deferred financing costs	(3,284)	–	–	–	(3,284)
Issuance of common stock in connection with employee benefit plans	534	–	–	–	534
Payment of costs associated with issuance of common stock and tangible equity units	(915)	–	–	–	(915)
Payment of dividend for Mandatory Redeemable Preferred Stock	(8,135)	–	–	–	(8,135)
Dividends paid	(30,067)	–	–	–	(30,067)
Contributions made by noncontrolling interests	–	–	1,492	–	1,492
Distributions to noncontrolling interests	–	–	(31,823)	–	(31,823