

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

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_ .

Commission file number: 001-14057

KINDRED HEALTHCARE, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of

61-1323993  
(I.R.S. Employer





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

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

See accompanying notes.

## KINDRED HEALTHCARE, INC.

## CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)

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

See accompanying notes.



## KINDRED HEALTHCARE, INC.

## CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

(In thousands, except per share amounts)

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

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

See accompanying notes.

## KINDRED HEALTHCARE, INC.

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

(In thousands)

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

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

See accompanying notes.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

Business

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

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

Recently issued accounting requirements

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

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

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

## KINDRED HEALTHCARE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## NOTE 1 BASIS OF PRESENTATION (Continued)

## Equity

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

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

Income tax provision in connection with the issuance of common stock under employee benefit plans

Stock-based compensation amortization		8,011		8,011
Contribution made by noncontrolling interests			200	200
Distribution made to noncontrolling interests	(571)		(2,950)	(2,950)
Purchase of noncontrolling interests	(2,031)	1,316		1,316
Reclassification of noncontrolling interests	(7,242)		7,242	7,242
Balance at September 30, 2012	\$	\$ 1,335,575	\$ 36,225	\$ 1,371,800

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

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

#### Income taxes

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



KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 BASIS OF PRESENTATION (Continued)

Derivative financial instruments

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

Other information

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

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

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

Reclassifications

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

NOTE 2 DIVESTITURES

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

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

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

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 2 DIVESTITURES (Continued)

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

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

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

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

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

NOTE 3 DISCONTINUED OPERATIONS

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

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

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

## KINDRED HEALTHCARE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## NOTE 3 DISCONTINUED OPERATIONS (Continued)

A summary of discontinued operations follows (in thousands):

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

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

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

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

## KINDRED HEALTHCARE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## NOTE 3 DISCONTINUED OPERATIONS (Continued)

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

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

## NOTE 4 ACQUISITIONS

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

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

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

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

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

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

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

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



## KINDRED HEALTHCARE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## NOTE 5 REVENUES

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

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

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

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

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

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

## KINDRED HEALTHCARE, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

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

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

Shares used  
in the  
computation:

Weighted average shares outstanding basic computation	52,323	52,323	51,676	51,676	52,218	52,218	51,648	51,648
Dilutive effect of employee stock options				33				27
Adjusted weighted average shares outstanding diluted computation		52,323		51,709		52,218		51,675
Earnings (loss) per common share:								
Income (loss) from continuing operations	\$ (0.39)	\$ (0.39)	\$ 0.13	\$ 0.13	\$	\$	\$ 0.59	\$ 0.59
Discontinued operations:								
Income (loss) from operations	(0.41)	(0.41)	0.05	0.05	(0.47)	(0.47)	0.26	0.26
Loss on divestiture of operations	(1.24)	(1.24)	(0.04)	(0.04)	(1.49)	(1.49)	(0.07)	(0.07)
Income (loss) from discontinued operations								