KINDRED HEALTHCARE, INC
Form 10-Q
November 06, 2017

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, 2017

OR

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

SECURITIES EXCHANGE ACT OF 1934

For the transition period from to .

Commission file number: 001-14057

KINDRED HEALTHCARE, INC.

(Exact name of registrant as specified in its charter)

Delaware	61-1323993
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

680 South Fourth Street Louisville, KY	40202
(Address of principal executive offices)	(Zip Code)

(502) 596-7300

(Registrant's telephone number, including area code)

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

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

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

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

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

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

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

Class of Common Stock	Outstanding at October 31, 2017
Common stock, $0.25 par value	86,932,592 shares

KINDRED HEALTHCARE, INC.

FORM 10-Q

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KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenues	$1,477,141	$1,563,276	$4,550,841	$4,774,813
Salaries, wages and benefits	830,558	867,611	2,504,074	2,546,031
Supplies	73,344	85,469	231,229	263,679
Building rent	64,422	66,946	193,939	199,956
Equipment rent	8,537	9,911	26,285	31,280
Other operating expenses	155,949	167,453	496,934	500,787
General and administrative expenses (exclusive of depreciation and amortization expense included below)	258,834	262,051	800,493	848,945
Other income	(638)	(341)	(2,895)	(2,679)
Litigation contingency expense	4,000	-	4,000	2,840
Impairment charges	-	297,276	136,303	311,195
Restructuring charges	16,500	81,463	31,556	84,213
Depreciation and amortization	24,808	32,995	80,279	99,747
Interest expense	61,146	59,856	181,275	175,398
Investment income	(705)	(1,797)	(3,442)	(2,519)
	1,496,755	1,928,893	4,680,030	5,058,873
Loss from continuing operations before income taxes	(19,614)	(365,617)	(129,189)	(284,060)
Provision (benefit) for income taxes	(1,225)	283,630	(15,107)	314,106
Loss from continuing operations	(18,389)	(649,247)	(114,082)	(598,166)
Discontinued operations, net of income taxes:				
Loss from operations	(13,612)	(22,060)	(1,871)	(10,489)
Gain (loss) on divestiture of operations	(49,663)	-	(349,868)	179
Loss from discontinued operations	(63,275)	(22,060)	(351,739)	(10,310)
Net loss	(81,664)	(671,307)	(465,821)	(608,476)
Earnings attributable to noncontrolling interests:				
Continuing operations	(10,960)	(9,574)	(32,234)	(26,272)
Discontinued operations	(3,162)	(4,732)	(12,597)	(14,075)
	(14,122)	(14,306)	(44,831)	(40,347)
Loss attributable to Kindred	$(95,786)	$(685,613)	$(510,652)	$(648,823)
Amounts attributable to Kindred stockholders:				
Loss from continuing operations	$(29,349)	$(658,821)	$(146,316)	$(624,438)
Loss from discontinued operations	(66,437)	(26,792)	(364,336)	(24,385)
Net loss	$(95,786)	$(685,613)	$(510,652)	$(648,823)
Loss per common share:				

Basic:				
Loss from continuing operations	$(0.33)	$(7.58)	$(1.67)	$(7.20)
Discontinued operations:				
Loss from operations	(0.19)	(0.31)	(0.17)	(0.28)
Gain (loss) on divestiture of operations	(0.57)	-	(4.00)	-
Loss from discontinued operations	(0.76)	(0.31)	(4.17)	(0.28)
Net loss	$(1.09)	$(7.89)	$(5.84)	$(7.48)
Diluted:				
Loss from continuing operations	$(0.33)	$(7.58)	$(1.67)	$(7.20)
Discontinued operations:				
Loss from operations	(0.19)	(0.31)	(0.17)	(0.28)
Gain (loss) on divestiture of operations	(0.57)	-	(4.00)	-
Loss from discontinued operations	(0.76)	(0.31)	(4.17)	(0.28)
Net loss	$(1.09)	$(7.89)	$(5.84)	$(7.48)
Shares used in computing loss per common share:				
Basic	87,597	86,869	87,398	86,766
Diluted	87,597	86,869	87,398	86,766
Cash dividends declared and paid per common share	$-	$0.12	$0.12	$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,	
	2017	2016	2017	2016
Net loss	$(81,664)	$(671,307)	$(465,821)	$(608,476)
Other comprehensive income (loss):				
Available-for-sale securities (Note 12):				
Change in unrealized investment gains	44	278	1,453	1,461
Reclassification of gains realized in net loss	(45)	(1,333)	(1,700)	(1,202)
Net change	(1)	(1,055)	(247)	259
Interest rate swaps (Note 1):				
Change in unrealized gains (losses)	1,276	2,022	2,108	(3,761)
Reclassification of (gains) losses realized in net loss, net of payments	(182)	18	(505)	411
Net change	1,094	2,040	1,603	(3,350)
Income tax (expense) benefit related to items of other comprehensive income (loss)	-	(427)	-	1,389
Other comprehensive income (loss)	1,093	558	1,356	(1,702)
Comprehensive loss	(80,571)	(670,749)	(464,465)	(610,178)
Earnings attributable to noncontrolling interests	(14,122)	(14,306)	(44,831)	(40,347)
Comprehensive loss attributable to Kindred	$(94,693)	$(685,055)	$(509,296)	$(650,525)

See accompanying notes.

KINDRED HEALTHCARE, INC.

CONDENSED CONSOLIDATED BALANCE SHEET

(Unaudited)

(In thousands, except per share amounts)

	September 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 130,364	$ 137,061
Insurance subsidiary investments	98,079	108,966
Accounts receivable less allowance for loss of $103,997 September 30, 2017 and $71,070 December 31, 2016	1,218,200	1,172,078
Inventories	21,491	22,438
Income taxes	4,983	10,067
Assets held for sale	79,051	289,450
Other	66,463	63,693
	1,618,631	1,803,753
Property and equipment	1,686,504	1,531,598
Accumulated depreciation	(956,644)	(912,978)
	729,860	618,620
Goodwill	2,424,831	2,427,074
Intangible assets less accumulated amortization of $79,276 September 30, 2017 and $101,612 December 31, 2016	612,277	770,108
Insurance subsidiary investments	184,417	204,929
Other	301,735	288,240
Total assets (a)	$ 5,871,751	$ 6,112,724
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 176,353	$ 203,925
Salaries, wages and other compensation	370,213	397,486
Due to third party payors	48,791	41,320
Professional liability risks	55,668	65,284
Accrued lease termination fees	109,113	5,224
Other accrued liabilities	264,957	264,512
Long-term debt due within one year	18,247	27,977
	1,043,342	1,005,728
Long-term debt	3,302,936	3,215,062
Professional liability risks	315,322	295,311
Deferred tax liabilities	182,065	201,808
Deferred credits and other liabilities	497,436	353,294

Commitments and contingencies (Note 14)		
Equity:		
Stockholders' equity:		
Common stock, $0.25 par value; authorized 175,000 shares; issued 86,980 shares September 30, 2017 and 85,166 shares December 31, 2016	21,745	21,291
Capital in excess of par value	1,710,480	1,710,231
Accumulated other comprehensive income	2,929	1,573
Accumulated deficit	(1,431,196)	(920,544)
	303,958	812,551
Noncontrolling interests	226,692	228,970
Total equity	530,650	1,041,521
Total liabilities (a) and equity	$ 5,871,751	$ 6,112,724

(a) The Company’s consolidated assets as of September 30, 2017 and December 31, 2016 include total assets of variable interest entities of $404.2 million and $394.1 million, respectively, which can only be used to settle the obligations of the variable interest entities. The Company’s consolidated liabilities as of September 30, 2017 and December 31, 2016 include total liabilities of variable interest entities of $41.8 million and $38.9 million, respectively. 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,	
	2017	2016	2017	2016
Cash flows from operating activities:				
Net loss	$(81,664)	$(671,307)	$(465,821)	$(608,476)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Depreciation expense	22,696	34,914	79,001	103,306
Amortization of intangible assets	2,889	5,468	11,909	18,251
Amortization of stock-based compensation costs	5,329	3,015	13,316	13,058
Amortization of deferred financing costs	4,363	3,987	12,847	11,262
Payment of capitalized lender fees related to debt amendment	-	(42)	(5,403)	(7,375)
Provision for doubtful accounts	10,327	10,009	57,511	30,955
Deferred income taxes	(3,788)	279,172	(19,608)	308,470
Impairment charges	-	324,289	137,572	338,208
(Gain) loss on divestiture of discontinued operations	49,663	-	349,868	(179)
Other	9,299	6,303	16,111	7,262
Change in operating assets and liabilities:				
Accounts receivable	(3,976)	(42,832)	(103,199)	(143,953)
Inventories and other assets	(6,999)	11,871	(9,517)	(3,522)
Accounts payable	(3,903)	11,995	(26,213)	24,451
Income taxes	2,369	1,615	6,718	2,468
Due to third party payors	20,614	24,809	7,471	20,317
Other accrued liabilities	(18,738)	33,101	(54,051)	(73,268)
Net cash provided by operating activities	8,481	36,367	8,512	41,235
Cash flows from investing activities:				
Routine capital expenditures	(16,463)	(21,873)	(45,800)	(68,703)
Development capital expenditures	(6,415)	(8,386)	(17,711)	(27,112)
Acquisitions, net of cash acquired	-	(49,329)	(6,650)	(77,040)
Acquisition deposits	-	-	-	18,489
Sale of assets	5,494	3,739	5,494	4,962
Purchase of insurance subsidiary investments	(18,047)	(22,427)	(108,655)	(75,422)
Sale of insurance subsidiary investments	50,087	31,875	117,863	78,478
Net change in insurance subsidiary cash and cash equivalents	(10,053)	(14,680)	23,472	8,479
Net change in other investments	5,088	51	4,844	(33,347)
Other	(81)	(150)	(35)	(1,277)
Net cash provided by (used in) investing activities	9,610	(81,180)	(27,178)	(172,493)
Cash flows from financing activities:				
Proceeds from borrowings under revolving credit	426,700	489,200	1,214,300	1,267,200

Repayment of borrowings under revolving credit	(427,300)	(388,100)	(1,120,600)	(1,215,800)
Proceeds from issuance of term loan, net of discount	-	-	-	198,100
Proceeds from other long-term debt	-	-	-	750
Repayment of term loan	(3,508)	(3,508)	(10,525)	(10,019)
Repayment of other long-term debt	(217)	(276)	(840)	(826)
Payment of deferred financing costs	(170)	(50)	(299)	(342)
Issuance of common stock in connection with employee benefit plans	-	-	32	-
Payment of dividend for mandatory redeemable preferred stock	(3,120)	(2,904)	(9,195)	(8,558)
Dividends paid	-	(10,224)	(10,228)	(30,517)
Contributions made by noncontrolling interests	-	4,993	113	11,261
Distributions to noncontrolling interests	(10,071)	(4,694)	(48,372)	(35,240)
Purchase of noncontrolling interests	-	-	-	(1,000)
Payroll tax payments for equity awards issuance	(88)	(250)	(2,417)	(3,079)
Net cash provided by (used in) financing activities	(17,774)	84,187	11,969	171,930
Change in cash and cash equivalents	317	39,374	(6,697)	40,672
Cash and cash equivalents at beginning of period	130,047	100,056	137,061	98,758
Cash and cash equivalents at end of period	$130,364	$139,430	$130,364	$139,430
Supplemental information:				
Interest payments	$76,085	$73,755	$186,075	$181,227
Income tax payments (refunds)	263	1,075	(2,054)	2,184
Non-cash contributions made by noncontrolling interests	-	-	1,150	2,800
Non-cash investing activities (see Note 4):				
Net sale proceeds from the SNF Divestiture (as defined) placed in third party escrow	500,572	-	500,572	-
Payments from third party escrow funds to landlords related to the SNF Divestiture	(500,572)	-	(500,572)	-

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 a home health, hospice and community care business, transitional care (“TC”) hospitals, inpatient rehabilitation hospitals (“IRFs”), and a contract rehabilitation services business across the United States (collectively, the “Company” or “Kindred”). At September 30, 2017, the Company’s Kindred at Home division primarily provided home health, hospice, and community care services from 609 sites of service in 40 states. The Company’s hospital division operated 77 TC hospitals (certified as long-term acute care (“LTAC”) hospitals under the Medicare program) in 18 states. The Company’s Kindred Rehabilitation Services division operated 19 IRFs and 101 hospital-based acute rehabilitation units (“ARUs”) (certified as IRFs), and provided rehabilitation services primarily in hospitals and long-term care settings in 45 states.

Discontinued operations

The Company has completed several transactions related to the divestiture of unprofitable hospitals and nursing centers to improve its future operating results. The Company is also currently in the process of completing the SNF Divestiture (as defined and described more fully in Note 4). For accounting purposes, the operating results of these businesses and the gains or losses 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. See Notes 4 and 5.

Recently issued accounting requirements

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

In May 2017, the FASB issued authoritative guidance to provide clarity and reduce diversity in practice when accounting for changes to terms or conditions of a share-based payment award. The new guidance is effective for annual and interim periods beginning after December 15, 2017 and early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company’s business, financial position, results of operations or liquidity.

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

In January 2017, the FASB issued authoritative guidance that revises the definition of a business, which affects accounting for acquisitions, disposals, goodwill impairment, and consolidation. The guidance is intended to help entities evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The revision provides a more robust framework to use in determining when a set of assets and activities is a business. The new guidance is effective for annual and interim periods beginning after December 15, 2017 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 November 2016, the FASB issued authoritative guidance that simplifies the disclosure of restricted cash within the statement of cash flows. The guidance is intended to reduce diversity when reporting restricted cash and requires entities to explain changes in the combined total of restricted and unrestricted balances in the statement of cash flows. The new guidance is effective for annual and interim periods beginning after December 15, 2017 and early adoption is permitted. The adoption of this standard is not expected to have a material impact on the Company's consolidated statement of cash flows.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Recently issued accounting requirements (Continued)

In August 2016, the FASB issued authoritative guidance to eliminate diversity in practice related to the cash flow statement classification of eight specific cash flow issues, which include debt prepayment or extinguishment costs, maturity of a zero coupon bond, settlement of contingent consideration liabilities after a business combination, proceeds from insurance settlements and distribution from certain equity method investees. The new guidance is effective for annual and interim periods beginning after December 15, 2017 and early adoption is permitted. The Company is still evaluating this standard and will continue to assess it.

In June 2016, the FASB issued authoritative guidance for accounting for credit losses on financial instruments. The new guidance introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments and modifies the impairment model for available-for-sale debt securities. The new guidance is effective for annual periods beginning after December 15, 2019 and early adoption is permitted beginning after December 15, 2018. The adoption of this standard is not expected to have a material impact on the Company's business, financial position, results of operations, and liquidity.

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

In January 2016, the FASB issued amended authoritative guidance which makes targeted improvements for financial instruments. The new provisions impact certain aspects of recognition, measurement, presentation and disclosure requirements of financial instruments. Specifically, the guidance will (1) require equity investments to be measured at fair value with changes in fair value recognized in net income, (2) simplify the impairment assessment of equity investments without readily determinable fair values, (3) eliminate the requirement to disclose the method and assumptions used to estimate fair value for financial instruments measured at amortized cost, and (4) require separate presentation of financial assets and financial liabilities by measurement category. The guidance is effective for annual and interim periods beginning after December 15, 2017, and early adoption is not 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 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.
- In March 2016, the FASB finalized its amendments to the guidance in the new revenue standard on assessing whether an entity is a principal or an agent in a revenue transaction. Under the new amendments, the FASB confirmed that a principal in an arrangement controls a good or service before it is transferred to a customer but revised the structure of indicators when an entity is the principal. The amendments have the same effective date and transition requirements as the new revenue standard.
- In May 2016, the FASB finalized its amendments to the guidance in the new revenue standard on contracts with customers and specifically, collectability, non-cash consideration, presentation of sales taxes, and completed contracts. The amendments are intended to reduce the risk of diversity in practice and the cost and complexity of applying certain aspects of the revenue standard. The amendments have the same effective date and transition requirements as the new revenue standard, which is effective for interim and annual periods beginning on or after December 15, 2017, with early adoption permitted on or after December 15, 2016.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Recently issued accounting requirements (Continued)

The Company will not elect early adoption but will apply the modified retrospective approach upon the required effective date. Based upon the Company’s assessment of the new guidance, it anticipates an opening balance sheet adjustment to reduce 2017 retained earnings in the range of $7 million to $10 million, which primarily relates to recognizing contractual adjustments to revenues earlier due primarily to variable considerations arising from its private payor portfolio. In addition, the Company anticipates a reclassification of bad debt expense to revenue contractual allowance in the range of $9 million to $12 million as a result of the provisions of the new standard in 2018. Management will continue to evaluate and review its estimates of the anticipated impact that the new guidance will have on its revenue recognition policies, procedures, financial position, results of operations, financial disclosures and control policies through December 31, 2017.

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, 2017 and 2016 (in thousands):

For the nine months ended September 30, 2017	Amounts attributable to Kindred stockholders	Noncontrolling interests	Total equity
Balance at December 31, 2016	$ 812,551	$ 228,970	$ 1,041,521
Comprehensive income (loss):			
Net income (loss)	(510,652)	44,831	(465,821)
Other comprehensive income	1,356	-	1,356
	(509,296)	44,831	(464,465)
Issuance of common stock in connection with employee benefit plans	32	-	32
Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(2,417)	-	(2,417)
Amortization of stock-based compensation	13,316	-	13,316
Dividends paid	(10,228)	-	(10,228)
Distributions to noncontrolling interests	-	(48,372)	(48,372)
Contributions made by noncontrolling interests (cash and non-cash)	-	1,263	1,263
Balance at September 30, 2017	$ 303,958	$ 226,692	$ 530,650
For the nine months ended September 30, 2016			
Balance at December 31, 2015	$ 1,499,854	$ 206,193	$ 1,706,047
Comprehensive income (loss):			
Net income (loss)	(648,823)	40,347	(608,476)
Other comprehensive loss	(1,702)	-	(1,702)
	(650,525)	40,347	(610,178)

Shares tendered by employees for statutory tax withholdings upon issuance of common stock	(3,079)	-	(3,079)
Income tax benefit in connection with the issuance of common stock under employee benefit plans	434	-	434
Amortization of stock-based compensation	13,058	-	13,058
Dividends paid	(30,517)	-	(30,517)
Contributions made by noncontrolling interests (cash and non-cash)	-	14,061	14,061
Distributions to noncontrolling interests	-	(35,240)	(35,240)
Purchase of noncontrolling interests	(234)	(2,158)	(2,392)
Balance at September 30, 2016	$ 828,991	$ 223,203	$ 1,052,194

Property and equipment

Beginning April 1, 2017, the Company changed the estimated useful life of certain information technology equipment and software based upon a detailed review of actual utilization. Following the acquisition of Gentiva (as defined in Note 6), the Company made significant investments in information technology and software. The actual usage and longevity of these assets supports longer lives than previously estimated. The change in estimate extended the expected useful life by one to two years depending on the asset category and has been accounted for prospectively. The impact from this change in accounting estimate was a decrease to loss from continuing operations before income taxes of approximately $3.2 million ($1.9 million net of income taxes) in the third quarter of 2017 and $7.1 million ($4.3 million net of income taxes) for the nine months ended September 30, 2017.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 1 – BASIS OF PRESENTATION (Continued)

Derivative financial instruments

In January 2016, the Company entered into three interest rate swap agreements to hedge its floating interest rate on an aggregate of $325 million of debt outstanding under its Term Loan Facility (as defined in Note 13). The interest rate swaps have an effective date of January 11, 2016, and expire on January 9, 2021. The Company is required to make payments based upon a fixed interest rate of 1.862% and 1.855% calculated on the notional amount of $175 million and $150 million, respectively. In exchange, the Company will receive interest on $325 million at a variable interest rate that is based upon the three-month London Interbank Offered Rate ("LIBOR"), subject to a minimum rate of 1.0%.

In March 2014, the Company entered into an interest rate swap agreement to hedge its floating interest rate on an aggregate of $400 million of debt outstanding under its Term Loan Facility. 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, 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 interest rate swaps were assessed for hedge effectiveness for accounting purposes and the Company determined the interest rate swaps qualify for cash flow hedge accounting at September 30, 2017. 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, 2017 and 2016, there was no ineffectiveness related to the interest rate swaps.

The aggregate fair value of the interest rate swaps recorded in other accrued liabilities was $0.6 million and $2.7 million at September 30, 2017 and December 31, 2016, respectively.

Variable interest entities

The Company follows the provisions of the authoritative guidance for determining whether an entity is a variable interest entity ("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.

Of the Company's 19 operating IRFs, 17 are partnerships subject to an operating and management services agreement. Under GAAP, the Company determined that 14 of these 17 partnerships qualify as VIEs and concluded that the Company is the primary beneficiary in all but one partnership. The Company holds an ownership interest and acts as manager in each of the partnerships. 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 upon 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 13 of the partnerships.

The analysis upon which the consolidation determination rests can be complex, can involve uncertainties, and requires 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 are as follows (in thousands):

	September 30, 2017	December 31, 2016
Assets:		
Current assets:		
Cash and cash equivalents	$ 40,848	$ 41,681
Accounts receivable, net	46,703	33,996
Inventories	1,633	1,641
Other	3,624	2,824
	92,808	80,142
Property and equipment, net	14,771	16,736
Goodwill	275,375	275,375
Intangible assets, net	21,211	21,839
Other	10	15
Total assets	$ 404,175	$ 394,107
Liabilities:		
Current liabilities:		
Accounts payable	$ 24,354	$ 23,345
Salaries, wages and other compensation	2,516	3,160
Other accrued liabilities	4,903	3,046
Long-term debt due within one year	1,037	1,571
	32,810	31,122
Long-term debt	149	455
Deferred credits and other liabilities	8,815	7,357
Total liabilities	$ 41,774	$ 38,934

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, 2016 filed with the Securities and Exchange Commission (the “SEC”) on Form 10-K. The accompanying condensed consolidated balance sheet at December 31, 2016 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 – 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 resulted from negotiations with each of the sellers that were based upon both the historical and expected future cash flows of the respective businesses. Each of these acquisitions was financed through operating cash flows and borrowings under the Company's ABL Facility (as defined in Note 13). Unaudited pro forma financial data related to the acquired businesses have not been presented because the acquisitions are not material individually to the Company's consolidated financial statements.

During the nine months ended September 30, 2017, the Company acquired three home health businesses for $6.7 million in cash.

During the third quarter of 2016, the Company acquired home health operations from the Arkansas Department of Health, which included licenses to provide home health, hospice and personal care services throughout the state of Arkansas, for approximately $39 million. In addition, the Company also acquired two certificates of need, one for home health and one for hospice, and an IRF Medicare license for $4.3 million, in aggregate.

In June 2016, the Company acquired five LTAC hospitals (233 licensed beds) operated by Select Medical Holdings Corporation ("Select") and sold three of its LTAC hospitals (255 licensed beds) to Select. In the third quarter of 2016, the Company paid Select $6 million in lieu of selling another LTAC hospital to Select. In connection with the facility swap with Select, the Company recorded a gain of $0.9 million ($0.5 million net of income taxes) during the nine months ended September 30, 2016.

In addition, during the nine months ended September 30, 2016, the Company acquired four home health and hospice businesses for $26.3 million in cash. The Company also acquired a hospice business in exchange for $9.0 million of outstanding accounts receivable owed to the Company.

NOTE 3 – IMPAIRMENT CHARGES

During the nine months ended September 30, 2017, the Company recorded asset impairment charges of $134.6 million related to the previously acquired RehabCare trade name ($97.4 million) and customer relationship intangible asset ($37.2 million) due to the expected loss of affiliated contracts related to the SNF Divestiture (as defined in Note 4) and cancellation of non-affiliated contracts. The fair value of the trade name was measured using Level 3 inputs, such as projected revenues and royalty rate. The fair value of the customer relationship intangible asset was measured using Level 3 inputs, such as discounted projected future operating cash flows.

During the nine months ended September 30, 2017, the Company also recorded asset impairment charges of $1.3 million related to a hospital certificate of need ($0.7 million) and a Medicare certification for an IRF ($0.6 million) after completing the annual indefinite-lived intangible assets impairment review at May 1, 2017. The fair value of the certificate of need was measured using Level 3 inputs, such as operating cash flows. The fair value of the Medicare certification was measured using a pending offer, a Level 3 input.

In addition, during the nine months ended September 30, 2017, the Company recorded an asset impairment charge of $0.4 million related to a valuation adjustment for a building within the Kindred at Home division. The fair value of the building was measured using Level 3 inputs, primarily replacement cost.

On October 1, 2016, the Company completed the sale of 12 LTAC hospitals (the "Hospitals") to a group of entities operating under the name "Curahealth", which are affiliates of a private investment fund sponsored by Nautic Partners, LLC (the "Curahealth Disposal"). In connection with (1) the Curahealth Disposal, (2) the closure of three LTAC hospitals in the third quarter of 2016, (3) a reduction in revenues associated with revenue rate reductions announced by the Center of Medicare and Medicaid Services ("CMS") on August 2, 2016, (4) continued increases in labor costs during 2016, and (5) a refinement of the impact of LTAC patient criteria that became effective for the majority of the Company's LTAC hospitals on September 1, 2016 (collectively, the "Hospital Division Triggering Event"), the Company was required to assess the recoverability of the hospital division reporting unit goodwill in the third quarter of 2016.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 3 – IMPAIRMENT CHARGES (Continued)

The goodwill impairment test involved a two-step process. The first step was a comparison of the reporting unit's fair value to its carrying value. To determine the fair value of the hospital division reporting unit, the Company used a combination of an income approach and a market approach to calculate the fair value of the reporting unit. The discounted cash flow that served as the primary basis for the income approach was based upon the hospital division's financial forecast of revenue, gross profit margins, operating costs and cash flows. As a result of the Hospital Division Triggering Event, the Company concluded that the carrying value of the hospital division reporting unit exceeded its estimated fair value. The second step of the test was then performed to measure the impairment loss, a process which compared the implied fair value of goodwill to the implied fair value for the reporting unit. The Company determined that a goodwill impairment charge aggregating $261.1 million was necessary during the third quarter of 2016. The Company also assessed the recoverability of the hospital division intangible assets and property and equipment and concluded a property and equipment impairment charge of $3.2 million was necessary during the third quarter of 2016. The fair value of the assets was measured using Level 3 inputs such as operating cash flows, market data and replacement cost factoring in depreciation, economic obsolescence and inflation trends. The impairment charges did not impact the Company's cash flows or liquidity.

During the third quarter of 2016, the Hospitals met assets held for sale criteria and were subsequently sold to Curahealth on October 1, 2016. The Company recorded impairment charges in connection with the sale aggregating $33.0 million, of which $19.7 million was related to property and equipment, and $13.3 million was related to goodwill and other intangible assets. The fair value of the assets was measured using a Level 3 input of the then pending offer. In addition, in the first quarter of 2016, the Company also recorded a property and equipment impairment charge of $7.8 million under the held and used accounting model related to the planned Curahealth Disposal. The fair value of property and equipment in the first quarter of 2016 was measured using Level 3 inputs, primarily replacement costs.

During the nine months ended September 30, 2016, the Company also recorded an impairment charge of $3.5 million related to certificates of need for two hospitals as part of the annual indefinite-lived intangible assets impairment review at May 1, 2016. The fair value of the certificates of need was measured using Level 3 inputs, such as operating cash flows.

In addition, during the nine months ended September 30, 2016, the Company recorded an asset impairment charge of $2.6 million related to the sale of a hospital division medical office building. The fair value of the property was measured using a Level 3 input of the then pending offer.

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

Each of the impairment charges discussed above reflects the amount by which the carrying value of the assets exceeded its estimated fair value at each impairment date.

All of the above mentioned charges are included in the impairment charges line on the statement of operations for all periods.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 4 – DIVESTITURES

Skilled nursing facility business exit

On June 30, 2017, the Company entered into a definitive agreement with BM Eagle Holdings, LLC, a joint venture led by affiliates of BlueMountain Capital Management, LLC (“BlueMountain”), under which the Company agreed to sell its skilled nursing facility business for $700 million in cash (the “SNF Divestiture”). The sale includes 89 nursing centers with 11,308 licensed beds and seven assisted living facilities with 380 licensed beds in 18 states. During the third quarter of 2017, the Company completed the sale of 54 of the skilled nursing facilities for $519.4 million. The sale proceeds were deposited with an escrow agent and after paying closing costs and applying repair credits, net cash proceeds totaled $501.6 million. The escrow agent directly paid $500.6 million of the net cash proceeds to Ventas, Inc. (“Ventas”) and another landlord. The remaining net cash proceeds of $1.0 million was directly paid to Kindred, which is reflected in the sale of assets in the investing activities in the accompanying unaudited condensed consolidated statement of cash flows. On October 1, 2017, the Company completed the sale of an additional 12 of the skilled nursing facilities and four of the assisted living facilities for $107.5 million.

As previously disclosed, 36 of the skilled nursing facilities (the “Ventas Properties”) were or continue to be leased from Ventas and the Company has an option to acquire the real estate of the Ventas Properties for aggregate consideration of $700 million. As the Company closes on the sale of the Ventas Properties, the Company will pay to Ventas the allocable portion of the $700 million purchase price for the Ventas Properties and Ventas will convey or has conveyed the real estate for the applicable Ventas Property to BlueMountain or its designee. The Company, through an escrow agent, has paid $488.1 million to Ventas for the Ventas Properties in connection with the closings that occurred during the third quarter of 2017. The Company, through an escrow agent, paid an additional $82.5 million to Ventas for the Ventas Properties in connection with the closings that occurred on October 1, 2017.

The completion of the remainder of the sales is subject to customary conditions to closing, including the receipt of all licensure, regulatory and other approvals. The Company expects that the remainder of the sales will occur in phases as regulatory and other approvals are received. The Company expects that nearly all of the closings will be completed by year end.

In accordance with authoritative guidance for assets held for sale and discontinued operations accounting, the skilled nursing facility business is reported as assets held for sale and was moved to discontinued operations for all periods presented.

During the third quarter of 2017, the Company recorded $51.3 million of pretax charges related to the SNF Divestiture, including a $2.7 million lease termination accrual, $23.8 million of transaction and other costs, a $17.9 million loss on sale-leaseback transaction, and $6.9 million of retention costs.

During the nine months ended September 30, 2017, the Company recorded $346.3 million of pretax charges related to the SNF Divestiture, including a $265.0 million lease termination accrual, $42.2 million of transaction and other costs, a $17.9 million loss on sale-leaseback transaction, and $21.2 million of retention costs.

In connection with the SNF Divestiture, the Company entered into an interim management agreement in the third quarter of 2017 with certain affiliates of BlueMountain in the state of California whereby the Company would lease its license of certain operations to such affiliates until licensure approval is obtained. Because the Company has continuing involvement in the business through purveying certain rights of ownership of the assets while under the interim management agreement and license sublease, the Company does not meet the requirements for a sale-leaseback transaction as described in ASC 840-40, Leases - Sale-Leaseback Transactions. Under the failed-sale-leaseback accounting model, the Company is deemed under GAAP to still own certain real estate assets sold to BlueMountain, which the Company must continue to reflect in its consolidated balance sheet and depreciate over the assets' remaining useful life. The Company must also treat a portion of the pretax cash proceeds from the SNF Divestiture as though it were the result of a $140.8 million other long-term liability financing obligation in its accompanying unaudited condensed consolidated balance sheet, and must also defer a $17.9 million gain associated with some of these assets until continuing involvement ceases. The lease will terminate upon licensure approval, at which time the Company will cease to recognize the remaining other long-term liability financing obligation, as well as the remaining net book value of the real estate assets and will recognize the gain.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 5 – DISCONTINUED OPERATIONS

In accordance with the authoritative guidance for the impairment or disposal of long-lived assets, the divestitures of unprofitable businesses discussed in Note 1 have been accounted for as discontinued operations. Accordingly, the results of operations of these businesses for all periods presented and the gains or losses 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.

In June 2017, the Company entered into a definitive agreement regarding the SNF Divestiture. In connection with the SNF Divestiture, the results of operations of the skilled nursing facility business, which previously were reported in the nursing center division, and the gains or losses associated with the SNF Divestiture, have been classified as discontinued operations for all periods presented. In addition, direct overhead and the profits from applicable RehabCare contracts servicing the Company’s skilled nursing facility business were moved to discontinued operations for all periods presented. During the third quarter of 2017, the Company reclassified from discontinued operations to continuing operations for all periods presented historical profits from certain RehabCare contracts that were retained with new operators of divested skilled nursing facilities. The Company has reclassified certain retained businesses and expenses previously reported in the nursing center division to other business segments, including hospital-based sub-acute units and a skilled nursing facility to the hospital division and a small therapy business to the Kindred Hospital Rehabilitation Services operating segment for all periods presented. See Note 4.

During 2016, the nursing center division experienced a decline in financial performance as compared to projected results and in the third quarter of 2016, the Company determined it was more likely than not that it would dispose of its skilled nursing facility business. As a result, the Company tested the recoverability of its nursing center division intangible assets and property and equipment under the held and used accounting model. No goodwill existed on the nursing centers reporting unit’s balance sheet at September 30, 2016. The Company determined that a property and equipment impairment charge aggregating $21.7 million was necessary during the third quarter of 2016. The fair value of the assets was measured using Level 3 inputs, such as operating cash flows and replacement costs.

During the third quarter of 2016, the Company reviewed the long-lived assets related to the planned divestiture and pending offers for a nursing center held for sale and determined its property and equipment was impaired. As a result, the Company recorded an impairment charge of $5.3 million. The fair value of the assets was measured based upon the then pending offers, a Level 3 input. The impairment charge did not impact the Company’s cash flows or liquidity.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 5 – DISCONTINUED OPERATIONS (Continued)

The following table summarizes (in thousands) the SNF Divestiture liability activity (included in current liabilities) during the nine months ended September 30, 2017, which does not include non-cash charges of $0.9 million related to other costs:

	Retention	Transaction and other costs	Lease termination costs	Total
Liability balance at December 31, 2016	$3,920	$ 420	$ 12,777	$17,117
Expense	21,154	41,310	264,999	327,463
Payments	(10,419)	(30,626)	(171,788)	(212,833)
Liability balance at September 30, 2017	$14,655	$ 11,104	$ 105,988	$131,747

A summary of discontinued operations follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Revenues	$184,739	$256,105	$691,796	$780,832
Salaries, wages and benefits	79,495	95,149	268,079	286,927
Supplies	8,488	10,708	29,654	32,457
Building rent	16,538	20,125	57,507	60,585
Equipment rent	1,644	1,903	5,845	5,895
Other operating expenses	57,871	72,156	204,005	216,026
General and administrative expenses	33,660	45,764	117,006	138,256
Other income	(179)	(151)	(495)	(585)
Impairment charges	-	27,013	1,268	27,013
Restructuring charges	-	-	-	4,010
Depreciation and amortization	777	7,387	10,631	21,810
Interest expense	5	12	17	36
Investment income	(16)	(14)	(53)	(44)
	198,283	280,052	693,464	792,386
Loss from operations before income taxes	(13,544)	(23,947)	(1,668)	(11,554)
Provision (benefit) for income taxes	68	(1,887)	203	(1,065)
Loss from operations	(13,612)	(22,060)	(1,871)	(10,489)
Gain (loss) on divestiture of operations	(49,663)	-	(349,868)	179
Loss from discontinued operations	(63,275)	(22,060)	(351,739)	(10,310)

Earnings attributable to noncontrolling interests	(3,162)	(4,732)	(12,597)	(14,075)
Loss attributable to Kindred	$(66,437)	$(26,792)	$(364,336)	$(24,385)

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 5 – 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,	
	2017	2016	2017	2016
Revenues:				
Nursing center division	$184,307	$255,594	$690,387	$779,439
Hospital division	432	511	1,409	1,393
	$184,739	$256,105	$691,796	$780,832
Segment adjusted operating income:				
Nursing center division	$4,909	$31,899	$71,622	$106,275
Hospital division	495	580	1,925	1,476
	$5,404	$32,479	$73,547	$107,751
Rent:				
Nursing center division:				
Building rent	$16,068	$19,657	$56,101	$59,190
Equipment rent	1,644	1,903	5,845	5,895
	17,712	21,560	61,946	65,085
Hospital division:				
Building rent	470	468	1,406	1,395
Equipment rent	-	-	-	-
	470	468	1,406	1,395
Totals:				
Building rent	16,538	20,125	57,507	60,585
Equipment rent	1,644	1,903	5,845	5,895
	$18,182	$22,028	$63,352	$66,480
Depreciation and amortization:				
Nursing center division	$777	$7,387	$10,631	$21,810
Hospital division	-	-	-	-
	$777	$7,387	$10,631	$21,810

The following table sets forth a summary of assets held for sale related to the SNF Divestiture (in thousands):

	September 30,	December 31,

	2017	2016
Current assets:		
Property and equipment, net	$ 58,456	$ 259,966
Intangible assets, net	13,844	20,127
Other	6,751	9,357
	79,051	289,450
Current liabilities (included in other accrued liabilities)	(9,250)	-
	$ 69,801	$ 289,450

NOTE 6 – RESTRUCTURING CHARGES

The Company has initiated various restructuring activities whereby it has incurred costs associated with reorganizing its operations, including the divestiture, swap, closure and consolidation of facilities and branches, reduced headcount and realigned operations in order to improve cost efficiencies in response to changes in the healthcare industry and to partially mitigate reductions in reimbursement rates from third party payors. The costs associated with these activities are reported as restructuring charges in the statement of operations and would have been recorded as general and administrative expense or rent expense if not classified as restructuring charges.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 6 – RESTRUCTURING CHARGES (Continued)

The following table sets forth the restructuring charges incurred by business segment (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Kindred at Home:				
Home health	$1,024	$1,240	$7,869	$1,976
Hospice	202	541	4,246	1,203
	1,226	1,781	12,115	3,179
Hospital division	13,867	78,476	17,318	78,743
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services	-	128	-	128
RehabCare	-	586	-	586
	-	714	-	714
Support center	1,407	492	2,123	1,577
	$16,500	$81,463	$31,556	$84,213

Restructuring Activities:

LTAC Hospital Portfolio Repositioning 2017 Plan

During the third quarter of 2017, the Company approved phase two of the LTAC hospital portfolio repositioning plan that incorporated the closure and conversion of certain LTAC hospitals as part of its mitigation strategies in response to the new patient criteria for LTAC hospitals under the Pathway for SGR Reform Act of 2013 (the “LTAC Legislation”). The activities related to the LTAC hospital portfolio repositioning 2017 plan are expected to be substantially completed by the end of 2018.

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Lease termination costs	$ 564	$ -	$ 564	$ -
Severance	3,513	-	3,513	-
Asset write-offs	9,141	-	9,141	-
	$ 13,218	$ -	$ 13,218	$ -

The following table (in thousands) summarizes the Company’s LTAC hospital portfolio repositioning 2017 plan liability activity (included in current liabilities) during the nine months ended September 30, 2017, which does not include non-cash charges of $9.1 million related to asset write-offs:

	Severance
Liability balance at December 31, 2016	$ -
Expense	3,513
Payments	(2,280)
Liability balance at September 30, 2017	$ 1,233

LTAC Hospital Portfolio Repositioning 2016 Plan

During the first quarter of 2016, the Company approved the LTAC hospital portfolio repositioning 2016 plan that incorporated the divestiture, swap or closure of certain LTAC hospitals as part of its mitigation strategies to prepare for new patient criteria for LTAC hospitals under the LTAC Legislation. The activities related to the LTAC hospital portfolio repositioning 2016 plan were substantially completed during 2016.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 6 – RESTRUCTURING CHARGES (Continued)

Restructuring Activities (Continued):

LTAC Hospital Portfolio Repositioning 2016 Plan (Continued)

The composition of the restructuring charges that the Company has incurred for these activities is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Lease termination costs	$649	$56,869	$2,813	$56,869
Facility closure costs and gain on disposal	-	955	232	(148)
Asset write-offs	-	19,257	1,055	19,257
Severance	-	1,395	-	2,765
Transaction costs	-	492	-	1,577
	$649	$78,968	$4,100	$80,320

The following table (in thousands) summarizes the Company's LTAC hospital portfolio repositioning 2016 plan liability activity (included in accrued lease termination fees, and deferred credits and other liabilities) during the nine months ended September 30, 2017, which does not include non-cash charges of $1.1 million related to asset write-offs:

	Lease termination costs
Liability balance at December 31, 2016	$ 40,649
Expense	2,813
Payments	(8,608)
Liability balance at September 30, 2017	$ 34,854

Kindred at Home 2017 Efficiency Initiative

During the first quarter of 2017, the Kindred at Home division approved and initiated a cost and operations efficiency initiative to address increases in labor costs associated with competitive labor markets and the integration of pay practices from acquisitions across the Kindred at Home portfolio. This initiative includes the consolidation and closure of under-performing branches and a reduction in force associated with the restructuring of divisional and regional support teams. These activities will be substantially completed during 2017.

The composition of the restructuring costs that the Company has incurred for these activities is as follows (in thousands):

	Three months ended September 30, 2017	2016	Nine months ended September 30, 2017	2016
Lease termination costs	$ 700	$ -	$ 1,470	$ -
Asset write-offs	300	-	4,616	-
Severance	732	-	2,423	-
Gain on disposal	(718)	-	(718)	-
	$ 1,014	$ -	$ 7,791	$ -

The following table (in thousands) summarizes the related restructuring liability activity (included in current liabilities) during the nine months ended September 30, 2017, which does not include non-cash charges of $4.6 million related to asset write-offs:

	Lease termination costs	Severance	Total
Liability balance at December 31, 2016	$ -	$ -	$ -
Expense	1,470	2,423	3,893
Payments	(301)	(2,224)	(2,525)
Other	-	39	39
Liability balance at September 30, 2017	$ 1,169	$ 238	$ 1,407

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 6 – RESTRUCTURING CHARGES (Continued)

Restructuring Activities (Continued):

Kindred at Home Branch Consolidations and Closures

During the first quarter of 2015, the Company approved and initiated branch consolidations and closures in specific markets to improve operations and cost efficiencies in the Kindred at Home division. The branch consolidations and closures included branches that served both the home health and hospice business segment operations. Gentiva Health Services, Inc. ("Gentiva"), a home health and hospice company acquired by the Company on February 2, 2015 (the "Gentiva Merger"), initiated similar branch consolidations and closures prior to the Gentiva Merger and these activities and acquired liabilities are included in the amounts below. These activities were substantially completed during 2016.

The composition of the restructuring costs that the Company has incurred for these consolidations and closures is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Lease termination costs	$212	$1,781	$1,117	$2,494
Branch closure and other costs	-	-	-	145
Asset write-offs	-	-	2,599	540
Severance	-	-	608	-
	$212	$1,781	$4,324	$3,179

The following table (in thousands) summarizes the related restructuring liability activity (included in current liabilities) during the nine months ended September 30, 2017, which does not include non-cash charges of $2.6 million related to asset write-offs:

	Lease termination costs	Severance	Total
Liability balance at December 31, 2016	$ 3,060	$ 1,343	$4,403
Expense	1,117	608	1,725
Payments	(3,049)	(2,175)	(5,224)
Other	(135)	224	89
Liability balance at September 30, 2017	$ 993	$ -	$993

NOTE 7 – 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,	
	2017	2016	2017	2016
Medicare	$774,626	$848,269	$2,388,258	$2,621,960
Medicaid	106,119	110,228	323,195	317,328
Medicare Advantage	121,119	122,167	360,286	367,158
Medicaid Managed	49,662	42,061	150,853	120,107
Other	446,443	465,031	1,395,272	1,423,646
	1,497,969	1,587,756	4,617,864	4,850,199
Eliminations	(20,828)	(24,480)	(67,023)	(75,386)
	$1,477,141	$1,563,276	$4,550,841	$4,774,813

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 8 – LOSS PER SHARE AND DIVIDENDS

Loss per common share is based upon the weighted average number of common shares outstanding during the respective periods. Because the Company reported a loss from continuing operations attributable to the Company for both the three months ended September 30, 2017 and 2016, and for both the nine months ended September 30, 2017 and 2016, the diluted calculation of earnings per common share excludes the dilutive impact of stock options and the Company’s 172,500 tangible equity units (the “Units”) of 1.4 million for both the third quarter of 2017 and for the nine months ended September 30, 2017 and 1.7 million for both the third quarter of 2016 and for the nine months ended September 30, 2016. 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. However, because the Company reported a loss from continuing operations attributable to the Company, there was no allocation to participating unvested restricted stockholders for all periods presented.

During the nine months ended September 30, 2017, the Company paid a cash dividend of $0.12 per common share on March 31, 2017. The Company’s Board of Directors elected to discontinue paying dividends on the Company’s common stock following the March 31, 2017 payment and instead redirected funds to repay debt and invest in growth.

During the nine months ended September 30, 2016, the Company paid a cash dividend of $0.12 per common share on September 2, 2016 (to shareholders of record as of the close of business on August 18, 2016), June 10, 2016 and April 1, 2016.

The Company made installment payments on the Units of $18.75 per Unit on September 1, 2017 (to holders of record as of close of business on August 15, 2017), June 1, 2017 and March 1, 2017. The Company made installment payments on the Units of $18.75 per Unit on September 1, 2016 and March 1, 2016, and $18.76 per Unit on June 1, 2016. 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. 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.

NOTE 9 – BUSINESS SEGMENT DATA

The Company is organized into three operating divisions: the Kindred at Home division, the hospital division, and the Kindred Rehabilitation Services division. Based upon the authoritative guidance for business segments, the operating divisions represent five reportable operating segments, including (1) home health services, (2) hospice services, (3) hospitals, (4) Kindred Hospital Rehabilitation Services, and (5) RehabCare. 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.

The Company has reclassified certain retained businesses and expenses previously reported in the nursing center division, including hospital-based sub-acute units and a skilled nursing facility to the hospital division and a small therapy business to the Kindred Hospital Rehabilitation Services operating segment for all periods presented.

During the third quarter of 2017, the Company recorded a favorable settlement of $2.2 million related to certain RehabCare customer contracts for non-payment and related collection litigation (the “RehabCare Collection Litigation”). During the nine months ended September 30, 2017, the Company recorded a provision for doubtful accounts of $23.1 million related to the RehabCare Collection Litigation.

For segment purposes, the Company defines segment adjusted operating income (loss) as earnings before interest, income taxes, depreciation, amortization, and total rent reported for each of the Company’s operating segments, excluding litigation contingency expense, impairment charges, restructuring charges, transaction costs, and the allocation of support center overhead.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 9 – BUSINESS SEGMENT DATA (Continued)

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

	Three months ended September 30, 2017	Three months ended September 30, 2016	Nine months ended September 30, 2017	Nine months ended September 30, 2016
Revenues:				
Kindred at Home:				
Home health	$453,684	$449,958	$1,363,691	$1,318,549
Hospice	188,414	188,575	553,073	550,642
	642,098	638,533	1,916,764	1,869,191
Hospital division	503,138	588,943	1,600,593	1,888,447
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services	173,638	170,308	530,192	508,448
RehabCare	179,095	189,972	570,315	584,113
	352,733	360,280	1,100,507	1,092,561
	1,497,969	1,587,756	4,617,864	4,850,199
Eliminations:				
Kindred Hospital Rehabilitation Services	(18,376)	(22,330)	(59,610)	(69,515)
RehabCare	(1,893)	(1,632)	(5,638)	(4,136)
Hospitals	(559)	(518)	(1,775)	(1,735)
	(20,828)	(24,480)	(67,023)	(75,386)
	$1,477,141	$1,563,276	$4,550,841	$4,774,813
Loss from continuing operations:				
Segment adjusted operating income:				
Kindred at Home:				
Home health	$66,431	$75,073	$206,773	$218,044
Hospice	34,761	31,326	95,126	87,521
	101,192	106,399	301,899	305,565
Hospital division	61,455	83,940	246,473	347,866
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services	49,151	49,759	154,333	148,607
RehabCare	7,619	6,740	1,210	25,814
	56,770	56,499	155,543	174,421
Support center expenses	(60,323)	(62,823)	(182,909)	(203,289)
Litigation contingency expense	(4,000)	-	(4,000)	(2,840)
Impairment charges	-	(297,276)	(136,303)	(311,195)
Restructuring charges	(14,375)	(22,813)	(25,592)	(24,850)
Transaction costs	-	(2,982)	-	(6,513)
Building rent	(64,422)	(66,946)	(193,939)	(199,956)

Equipment rent	(8,537)	(9,911)	(26,285)	(31,280)
Restructuring charges - rent	(2,125)	(58,650)	(5,964)	(59,363)
Depreciation and amortization	(24,808)	(32,995)	(80,279)	(99,747)
Interest, net	(60,441)	(58,059)	(177,833)	(172,879)
Loss from continuing operations before income taxes	(19,614)	(365,617)	(129,189)	(284,060)
Provision (benefit) for income taxes	(1,225)	283,630	(15,107)	314,106
	$(18,389)	$(649,247)	$(114,082)	$(598,166)

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 9 – BUSINESS SEGMENT DATA (Continued)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Rent:				
Kindred at Home:				
Home health:				
Building	$7,993	$8,188	$24,218	$24,725
Equipment	251	284	831	1,005
	8,244	8,472	25,049	25,730
Hospice:				
Building	4,139	4,264	12,513	12,794
Equipment	82	78	254	253
	4,221	4,342	12,767	13,047
Hospital division:				
Building	43,193	45,173	130,126	134,627
Equipment	7,193	8,521	22,147	26,994
	50,386	53,694	152,273	161,621
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services:				
Building	8,559	8,448	25,463	25,329
Equipment	399	404	1,155	1,182
	8,958	8,852	26,618	26,511
RehabCare:				
Building	317	331	960	949
Equipment	585	594	1,816	1,748
	902	925	2,776	2,697
Support center:				
Building	221	542	659	1,532
Equipment	27	30	82	98
	248	572	741	1,630
Totals:				
Building	64,422	66,946	193,939	199,956
Equipment	8,537	9,911	26,285	31,280
	$72,959	$76,857	$220,224	$231,236
Depreciation and amortization:				
Kindred at Home:				

Home health	$2,662	$3,803	$8,281	$11,916
Hospice	946	1,563	3,333	4,688
	3,608	5,366	11,614	16,604
Hospital division	10,637	12,789	31,868	39,334
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services	3,808	3,576	11,206	10,629
RehabCare	338	2,011	3,779	5,983
	4,146	5,587	14,985	16,612
Support center	6,417	9,253	21,812	27,197
	$24,808	$32,995	$80,279	$99,747

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 9 – BUSINESS SEGMENT DATA (Continued)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Capital expenditures, excluding acquisitions (including discontinued operations):				
Kindred at Home:				
Home health:				
Routine	$1,105	$1,300	$3,209	$5,009
Development	-	-	-	-
	1,105	1,300	3,209	5,009
Hospice:				
Routine	674	637	1,717	1,928
Development	-	-	-	-
	674	637	1,717	1,928
Hospital division:				
Routine	3,325	5,649	10,325	17,499
Development	-	-	-	-
	3,325	5,649	10,325	17,499
Kindred Rehabilitation Services:				
Kindred Hospital Rehabilitation Services:				
Routine	621	380	2,264	1,058
Development	14	4,973	498	15,344
	635	5,353	2,762	16,402
RehabCare:				
Routine	264	698	634	1,205
Development	-	-	-	-
	264	698	634	1,205
Support center:				
Routine:				
Information systems	8,511	7,031	21,620	24,744
Other	396	692	1,304	4,013
	8,907	7,723	22,924	28,757
Development	6,386	2,828	17,170	5,845
	15,293	10,551	40,094	34,602
Discontinued operations - nursing centers:				
Routine	1,567	5,486	4,727	13,247
Development	15	585	43	5,923

	1,582	6,071	4,770	19,170
Totals:				
Routine	16,463	21,873	45,800	68,703
Development	6,415	8,386	17,711	27,112
	$22,878	$30,259	$63,511	$95,815

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 9 – BUSINESS SEGMENT DATA (Continued)

	September 30, 2017	December 31, 2016
Assets at end of period (including discontinued operations):		
Kindred at Home:		
Home health	$ 1,551,317	$ 1,540,370
Hospice	914,324	929,774
	2,465,641	2,470,144
Hospital division	1,274,200	1,232,541
Kindred Rehabilitation Services:		
Kindred Hospital Rehabilitation Services	824,780	815,804
RehabCare	185,062	329,516
	1,009,842	1,145,320
Support center	777,347	795,415
Discontinued operations - nursing centers	344,721	469,304
	$ 5,871,751	$ 6,112,724
Goodwill:		
Kindred at Home:		
Home health	$ 917,239	$ 919,482
Hospice	646,329	646,329
	1,563,568	1,565,811
Hospital division	361,310	361,310
Kindred Rehabilitation Services:		
Kindred Hospital Rehabilitation Services	499,953	499,953
RehabCare	-	-
	499,953	499,953
	$ 2,424,831	$ 2,427,074

NOTE 10 – INCOME TAXES

At each balance sheet date, management assesses all available positive and negative evidence to determine whether a valuation allowance is needed against its deferred tax assets. The authoritative guidance requires evidence related to events that have actually happened to be weighted more significantly than evidence that is projected or expected to happen. A significant piece of negative evidence according to this weighting standard is that there are cumulative losses in the two most recent years and the current year, which is the case for the Company at September 30, 2017 and December 31, 2016. The Company's outlook of taxable income for 2016 changed in the third quarter of 2016 after the Company recorded $286.0 million of goodwill and property and equipment impairment charges and announced the planned SNF Divestiture and related expected loss on divestiture for tax purposes. Accordingly, a full valuation allowance was recorded at both September 30, 2017 and December 31, 2016. The amount of deferred tax asset considered realizable, however, could be adjusted if the weighting of the positive and negative evidence changes.

The Company has deferred tax liabilities related to tax amortization of acquired indefinite-lived intangible assets because these assets are not amortized for financial reporting purposes. The tax amortization in current and future years created a deferred tax liability which will reverse at the time of ultimate sale or book impairment. Due to the uncertain timing of this reversal, the temporary difference associated with indefinite-lived intangible assets cannot be considered a source of future taxable income for purposes of determining the valuation allowance. As such, this deferred tax liability cannot be used to offset the deferred tax asset related to the net deferred tax assets. The Company has a net deferred tax liability of $182.1 million and $201.8 million as of September 30, 2017 and December 31, 2016, respectively, representing indefinite-lived intangible assets.

The Company's income tax benefit for the nine months ended September 30, 2017 is primarily driven by the RehabCare trade name impairment charge of $97.4 million recorded during the nine months ended September 30, 2017. The Company has a full valuation allowance on its net deferred tax assets with the exception of deferred tax liabilities related to indefinite-lived intangible assets. The impairment charge resulted in a reduction of those indefinite-lived intangible assets creating an income tax benefit. The income tax benefit for the nine months ended September 30, 2017 is limited to the forecasted income tax benefit for the full year of 2017.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 10 – INCOME TAXES (Continued)

The Company's effective income tax rate was 6.2% and 77.6% in the third quarter of 2017 and 2016, respectively, and 11.7% and 110.6% for the nine months ended September 30, 2017 and 2016, respectively. The reduction in the effective income tax rate in both periods of 2017 was attributable to the impact of recording the initial full deferred tax asset valuation allowance of $366.5 million in the third quarter of 2016. The increase in the valuation allowance was $7.4 million in the third quarter of 2017 and $40.2 million for the nine months ended September 30, 2017, net of the tax benefit associated with the $97.4 million RehabCare trade name impairment charge for the nine months ended September 30, 2017 and tax amortization related to indefinite-lived intangible assets in both periods.

NOTE 11 – INSURANCE RISKS

The Company insures a substantial portion of its professional liability risks and workers compensation risks through its wholly owned limited purpose insurance subsidiary, Cornerstone Insurance Company ("Cornerstone"). 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 Cornerstone.

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 reinsurance and insurance carriers, follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Professional liability:				
Continuing operations	$12,735	$12,851	$37,302	$42,545
Discontinued operations	7,505	6,719	25,437	19,129
Workers compensation:				
Continuing operations	$11,753	$14,209	$31,260	$39,225
Discontinued operations	2,770	2,746	5,425	6,060

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 11 – 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, 2017			December 31, 2016		
	Professional liability	Workers compensation	Total	Professional liability	Workers compensation	Total
Assets:						
Current:						
Insurance subsidiary investments	$55,194	$ 42,885	$98,079	$64,622	$ 44,344	$108,966
Reinsurance and other recoverables	7,697	1,623	9,320	7,912	1,488	9,400
Other	-	50	50	-	50	50
	62,891	44,558	107,449	72,534	45,882	118,416
Non-current:						
Insurance subsidiary investments	98,481	85,936	184,417	97,223	107,706	204,929
Reinsurance and other recoverables	115,224	107,551	222,775	111,596	101,984	213,580
Deposits	4,216	19,497	23,713	4,202	22,979	27,181
Other	92	-	92	-	-	-
	218,013	212,984	430,997	213,021	232,669	` 445,690
	$280,904	$ 257,542	$538,446	$285,555	$ 278,551	$564,106
Liabilities:						
Allowance for insurance risks:						
Current	$55,668	$ 46,401	$102,069	$65,284	$ 48,237	$113,521
Non-current	315,322	219,771	535,093	295,311	216,971	512,282
	$370,990	$ 266,172	$637,162	$360,595	$ 265,208	$625,803

Provisions for loss for professional liability risks retained by Cornerstone have been discounted based upon actuarial estimates of claim payment patterns using a discount rate of 1%. The discount rate is 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 $373.7 million at September 30, 2017 and $363.2 million at December 31, 2016.

Provisions for loss for workers compensation risks retained by Cornerstone are not discounted and amounts equal to the loss provision are funded annually.

In the third quarter of 2017, as a result of improved underwriting results, the Company received a distribution of $30 million (the “September Distribution”) from Cornerstone and has received distributions totaling $38 million from Cornerstone for the nine months ended September 30, 2017. The September Distribution was used to repay a portion of the Company’s ABL Facility. These distributions were completed in accordance with applicable regulations and had no impact on earnings or cash flows from operations.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 12 – INSURANCE SUBSIDIARY INVESTMENTS

The Company maintains investments, consisting principally of cash and cash equivalents, debt securities, 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. Due to a change in investment strategy, the Company liquidated all equities and reinvested the proceeds in debt securities during the second quarter of 2017.

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, 2017				December 31, 2016			
	Cost	Unrealized gains	Unrealized losses	Fair value	Cost	Unrealized gains	Unrealized losses	Fair value
Cash and cash equivalents (a)	$161,680	$ -	$ -	$161,680	$185,152	$ -	$ -	$185,152
Debt securities:								
Corporate bonds	53,583	4	(74)	53,513	55,239	37	(100)	55,176
Debt securities issued by U.S. government agencies	20,013	-	(77)	19,936	18,344	7	(63)	18,288
U.S. Treasury notes	18,151	-	(50)	18,101	24,763	6	(42)	24,727
	91,747	4	(201)	91,550	98,346	50	(205)	98,191
Equities by industry:								
Consumer	-	-	-	-	2,596	66	(150)	2,512
Technology	-	-	-	-	2,105	120	(23)	2,202
Financial services	-	-	-	-	1,641	213	(24)	1,830
Industrials	-	-	-	-	1,291	57	(19)	1,329
Healthcare	-	-	-	-	1,332	-	(86)	1,246
Other	-	-	-	-	6,530	109	(70)	6,569
	-	-	-	-	15,495	565	(372)	15,688
Certificates of deposit	9,264	3	(1)	9,266	14,850	14	-	14,864
Term deposit	20,000	-	-	20,000	-	-	-	-
	$282,691	$ 7	$ (202)	$282,496	$313,843	$ 629	$ (577)	$313,895

(a) Includes $15.5 million and $14.8 million of money market funds at September 30, 2017 and December 31, 2016, 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 Cornerstone.

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 Cornerstone. This ability to hold securities allows sufficient time for recovery of temporary declines in 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, 2017 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. The Company considered the severity and duration of its unrealized losses at September 30, 2016 and recognized pretax other-than-temporary-impairments of $0.2 million during the nine months ended September 30, 2016 for various investments held in its insurance subsidiary investment portfolio. These investments were determined to be impaired after considering the duration of the declines in values and the likelihood of near term price recovery of each investment. Because the Company considered the remaining unrealized losses at September 30, 2016 to be temporary, the Company did not record any additional impairment losses related to these investments.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 13 – LONG-TERM DEBT

Term Loan Facility

As used herein, “Term Loan Facility” means the Company’s $1.36 billion term loan credit facility provided pursuant to the terms and provisions of that certain Sixth Amended and Restated Term Loan Credit Agreement dated as of March 14, 2017 (the “Term Loan Amendment Agreement”), among the Company, the lenders from time to time party thereto, and JPMorgan Chase Bank, N.A., as administrative agent and collateral agent. All obligations under the Term Loan Facility are fully and unconditionally guaranteed, subject to certain customary release provisions, by substantially all of the Company’s wholly owned, domestic material subsidiaries, as well as certain other subsidiaries as the Company may determine from time to time in its sole discretion.

The Term Loan Facility (1) matures on April 9, 2021, (2) contains financial maintenance covenants in the form of a maximum total leverage ratio, a minimum fixed charge coverage ratio and a maximum amount of annual capital expenditures, (3) imposes restrictions on the Company’s ability to incur debt and liens and make acquisitions, investments and payments on equity and junior debt, and (4) provides for interest rate margins of 3.50% for LIBOR borrowings (subject to a floor of 1.00%) and 2.50% for base rate borrowings.

On March 14, 2017, the Company entered into the Term Loan Amendment Agreement that amended and restated the Term Loan Facility to, among other things, (1) make adjustments to certain covenants and definitions to better accommodate the SNF Divestiture, (2) provide the Company with increased leverage covenant flexibility for an interim period, (3) increase the applicable margin on the outstanding borrowings from 3.25% to 3.50% for LIBOR borrowings and from 2.25% to 2.50% for base rate borrowings, (4) require a maximum leverage ratio of no more than 5.00 to 1.00 for use of the $50 million annual dividend basket, and (5) provide for a prepayment premium of 1.00% in connection with any repricing transaction within six months of the closing date. In accordance with the authoritative guidance on debt, the Company accounted for the amendment as a debt modification.

ABL Facility

As used herein, “ABL Facility” means the Company’s $900 million asset-based loan revolving credit facility provided pursuant to the terms and provisions of that certain Fourth Amended and Restated ABL Credit Agreement dated as of June 14, 2016 among the Company, the lenders party thereto from time to time, and JPMorgan Chase Bank, N.A., as administrative agent and collateral agent, as amended on September 27, 2017. All obligations under the ABL Facility are fully and unconditionally guaranteed, subject to certain customary release provisions, by substantially all of the Company’s wholly owned, domestic material subsidiaries, as well as certain other subsidiaries as the Company may determine from time to time in its sole discretion.

The ABL Facility (1) matures on April 9, 2019, (2) contains financial maintenance covenants in the form of a minimum fixed charge coverage ratio and a maximum amount of annual capital expenditures, (3) imposes restrictions on the Company’s ability to incur debt and liens and make acquisitions, investments and payments on equity and junior debt, (4) provides for interest rate margins of 2.00% to 2.50% for LIBOR borrowings and 1.00% to 1.50% for base rate borrowings (in each case depending on average daily excess availability), and (5) employs a borrowing base calculation to determine total available capacity thereunder.

On September 27, 2017, the Company entered into an amendment to the ABL Facility to update the provisions pertaining to letters of credit issued thereunder.

NOTE 14 – 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.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 14 – CONTINGENCIES (Continued)

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 11.

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). 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”), 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 17.

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. The Company also is subject to indemnity claims under contracts with its Kindred Rehabilitation Services division customers related to the provision of its services. 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.

NOTE 15 – 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 15 – 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, 2017					
Recurring:					
Assets:					
Available-for-sale debt securities:					
Corporate bonds	$-	$53,513	$-	$ 53,513	$-
Debt securities issued by U.S. government agencies	-	19,936	-	19,936	-
U.S. Treasury notes	18,101	-	-	18,101	-
	18,101	73,449	-	91,550	-
Money market funds	16,974	-	-	16,974	-
Term deposit	-	20,000	-	20,000	
Certificates of deposit	-	9,266	-	9,266	-
Total available-for-sale investments	35,075	102,715	-	137,790	-
Deposits held in money market funds	300	4,216	-	4,516	-
	$35,375	$106,931	$-	$ 142,306	$-
Liabilities:					
Contingent consideration liability	$-	$-	$(3,335)	$ (3,335)	$-
Interest rate swaps	-	(609)	-	(609)	-
	$-	$(609)	$(3,335)	$ (3,944)	$-
Non-recurring:					
Assets:					
Property and equipment	$-	$-	$1,100	$ 1,100	$(1,742)
Intangible assets	-	-	500	500	(135,829)
	$-	$-	$1,600	$ 1,600	$(137,571)
Liabilities	$-	$-	$-	$ -	$-
December 31, 2016					
Recurring:					
Assets:					
Available-for-sale debt securities:					
Corporate bonds	$-	$55,176	$-	$ 55,176	$-
Debt securities issued by U.S. government agencies	-	18,288	-	18,288	-
U.S. Treasury notes	24,727	-	-	24,727	-

	24,727	73,464	-	98,191	-
Available-for-sale equity securities	15,688	-	-	15,688	-
Money market funds	16,472	-	-	16,472	-
Certificates of deposit	-	14,864	-	14,864	-
Total available-for-sale investments	56,887	88,328	-	145,215	-
Deposits held in money market funds	100	4,126	-	4,226	-
	$56,987	$92,454	$-	$ 149,441	$-
Liabilities:					
Contingent consideration liability	$-	$-	$(4,943)	$ (4,943)	$-
Interest rate swaps	-	(2,718)	-	(2,718)	-
	$-	$(2,718)	$(4,943)	$ (7,661)	$-
Non-recurring:					
Assets:					
Property and equipment	$-	$-	$650,222	$ 650,222	$(31,029)
Goodwill	-	-	361,310	361,310	(261,129)
Intangible assets - Hospitals	-	-	641	641	(3,559)
Intangible assets - Kindred at Home	-	-	19,010	19,010	(3,534)
Hospitals available for sale	-	-	-	-	(43,308)
	$-	$-	$1,031,183	$ 1,031,183	$(342,559)
Liabilities	$-	$-	$-	$ -	$-

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NOTE 15 – FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (Continued)

Recurring measurements

The Company’s available-for-sale investments held by Cornerstone consist of debt securities, money market funds, certificates of deposit and a term deposit. These available-for-sale investments and Cornerstone’s cash and cash equivalents of $146.2 million as of September 30, 2017 and $170.3 million as of December 31, 2016, 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 $1.5 million as of September 30, 2017 and $1.7 million as of December 31, 2016 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 money market funds is based upon quoted market prices and is generally classified as Level 1. The fair value of inactively traded debt securities, certificates of deposit and the term 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, 2017 or September 30, 2016.

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 $7.9 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, 2017, the fair value of the contingent consideration liability was $3.3 million. The change in fair value in the third quarter of 2017 was related to 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, 2017 Carrying value	Fair value	December 31, 2016 Carrying value	Fair value
Cash and cash equivalents	$130,364	$130,364	$137,061	$137,061
Insurance subsidiary investments	282,496	282,496	313,895	313,895
Long-term debt, including amounts due within one year (excluding capital lease obligations totaling $0.4 million and $0.6 million at September 30, 2017 and December 31, 2016, respectively)	3,320,813	3,287,484	3,242,459	3,220,291

Non-recurring measurements

During the nine months ended September 30, 2017, the Company recorded asset impairment charges of $134.6 million related to the previously acquired RehabCare trade name ($97.4 million) and customer relationship intangible asset ($37.2 million) due to the expected loss of affiliated contracts related to the SNF Divestiture and cancellation of non-affiliated contracts. The fair value of the trade name was measured using Level 3 inputs, such as projected revenues and royalty rate. The fair value of the customer relationship intangible asset was measured using Level 3 inputs, such as discounted projected future operating cash flows.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 15 – FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (Continued)

Non-recurring measurements (Continued)

During the nine months ended September 30, 2017, the Company also recorded asset impairment charges of $1.3 million related to a hospital certificate of need ($0.7 million) and a Medicare certification for an IRF ($0.6 million) as part of the annual indefinite-lived intangible assets impairment review at May 1, 2017. The fair value of the certificate of need was measured using Level 3 inputs, such as operating cash flows. The fair value of the Medicare certification was measured using a pending offer, a Level 3 input.

In addition, during the nine months ended September 30, 2017, the Company recorded an asset impairment charge of $0.4 million related to a valuation adjustment for a building within the Kindred at Home division. The fair value of the building was measured using Level 3 inputs, primarily replacement cost.

During the nine months ended September 30, 2017, the Company recorded an asset impairment charge of $1.3 million related to the SNF Divestiture and is recorded in discontinued operations. The fair value of property and equipment was measured using Level 3 inputs, primarily replacement costs.

During the third quarter of 2016, the Company recorded a goodwill impairment charge of $261.1 million and a property and equipment impairment charge of $3.2 million related to the Hospital Division Triggering Event. The fair value of the assets was measured using Level 3 inputs such as operating cash flows, market data and replacement cost factoring in depreciation, economic obsolescence and inflation trends.

During the third quarter of 2016, the Company recorded impairment charges aggregating $33.0 million, comprised of $19.7 million related to property and equipment, and $13.3 million related to goodwill and other intangible assets. The fair value of the assets was measured using a Level 3 input of the pending offer from Curahealth. In addition, during the nine months ended September 30, 2016, the Company recorded asset impairment charges of $7.8 million related to the Curahealth Disposal. The fair value of property and equipment was measured using Level 3 inputs, primarily replacement costs.

During the third quarter of 2016, the Company reviewed the long-lived assets related to the decline in financial performance of its nursing center division. After determining it was more likely than not that the Company would dispose of its skilled nursing facility business, the Company determined that its property and equipment was impaired. As a result, the Company recorded an impairment charge of $21.7 million and is recorded in discontinued operations. The fair value of the assets was measured using Level 3 inputs, such as operating cash flows and replacement costs.

During the third quarter of 2016, the Company reviewed the long-lived assets related to the planned divestiture and pending offers for a nursing center held for sale and determined its property and equipment was impaired. As a result, the Company recorded an impairment charge of $5.3 million and is recorded in discontinued operations. The fair value of the assets was measured based upon pending offers, a Level 3 input.

During the nine months ended September 30, 2016, the Company recorded an asset impairment charge of $2.6 million related to the sale of a medical office building. The fair value of the property was measured using a Level 3 input of the then pending offer.

During the nine months ended September 30, 2016, the Company also recorded an impairment charge of $3.5 million related to certificates of need for two hospitals as part of the annual indefinite-lived intangible assets impairment review at May 1, 2016. The fair value of the certificates of need was measured using Level 3 inputs, such as operating cash flows.

Each of the impairment charges discussed above reflects the amount by which the carrying value of the assets exceeded its estimated fair value at each impairment date.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – 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 $750 million aggregate principal amount of 8.00% Senior Notes due 2020 (the “Notes due 2020”), $500 million aggregate principal amount of 6.375% senior notes due 2022 (the “Notes due 2022”) and $600 million aggregate principal amount of 8.75% Senior Notes due 2023 (the “Notes due 2023”) are fully and unconditionally guaranteed by substantially all of the Company’s domestic 100% owned subsidiaries. The equity method has been used with respect to the parent company’s investment in subsidiaries.

The following unaudited condensed consolidating financial data present the financial position of the parent company/issuer, the guarantor subsidiaries and the non-guarantor subsidiaries as of September 30, 2017 and December 31, 2016, and the respective results of operations and cash flows for the three months and nine months ended September 30, 2017 and September 30, 2016.

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Operations and Comprehensive Income (Loss)

	Three months ended September 30, 2017				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$ -	$ 1,308,785	$ 193,957	$ (25,601)	$ 1,477,141
Salaries, wages and benefits	-	760,010	70,548	-	830,558
Supplies	-	63,899	9,445	-	73,344
Building rent	-	51,529	12,893	-	64,422
Equipment rent	-	7,375	1,162	-	8,537
Other operating expenses	-	142,003	13,946	-	155,949
General and administrative expenses	-	236,067	48,368	(25,601)	258,834
Other (income) expense	-	321	(959)	-	(638)
Litigation contingency expense	-	4,000	-	-	4,000
Restructuring charges	-	15,914	586	-	16,500
Depreciation and amortization	-	22,641	2,167	-	24,808
Management fees	-	(2,655)	2,655	-	-
Intercompany interest (income) expense from affiliates	(64,290)	59,147	5,143	-	-
Interest expense (income)	61,502	(368)	12	-	61,146
Investment income	-	(58)	(647)	-	(705)
Equity in net loss of consolidating affiliates	98,574	-	-	(98,574)	-
	95,786	1,359,825	165,319	(124,175)	1,496,755
Income (loss) from continuing operations before income taxes	(95,786)	(51,040)	28,638	98,574	(19,614)
Provision (benefit) for income taxes	-	(5,091)	3,866	-	(1,225)
Income (loss) from continuing operations	(95,786)	(45,949)	24,772	98,574	(18,389)
Discontinued operations, net of income taxes:					
Income (loss) from operations	-	(16,769)	3,157	-	(13,612)
Loss on divestiture of operations	-	(49,663)	-	-	(49,663)
Income (loss) from discontinued operations	-	(66,432)	3,157	-	(63,275)
Net income (loss)	(95,786)	(112,381)	27,929	98,574	(81,664)
Earnings attributable to noncontrolling interests:					

Continuing operations	-	-	(10,960)	-	(10,960)
Discontinued operations	-	-	(3,162)	-	(3,162)
	-	-	(14,122)	-	(14,122)
Income (loss) attributable to					
Kindred	$(95,786)	$(112,381)	$ 13,807	$ 98,574	$(95,786)
Comprehensive income (loss)	$(94,693)	$(112,381)	$ 27,928	$ 98,575	$(80,571)
Comprehensive income (loss) attributable to Kindred	$(94,693)	$(112,381)	$ 13,806	$ 98,575	$(94,693)

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

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

(In thousands)	Three months ended September 30, 2016 Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$-	$ 1,396,922	$ 191,882	$ (25,528)	$ 1,563,276
Salaries, wages and benefits	-	805,372	62,239	-	867,611
Supplies	-	74,813	10,656	-	85,469
Building rent	-	53,247	13,699		66,946
Equipment rent	-	8,494	1,417	-	9,911
Other operating expenses	-	152,868	14,585	-	167,453
General and administrative expenses	-	224,458	63,121	(25,528)	262,051
Other (income) expense	-	350	(691)	-	(341)
Impairment charges	-	175,604	121,672	-	297,276
Restructuring charges	-	80,268	1,195	-	81,463
Depreciation and amortization	-	30,881	2,114	-	32,995
Management fees	-	(2,277)	2,277	-	-
Intercompany interest (income) expense from affiliates	(56,169)	44,525	11,644	-	-
Interest expense (income)	59,859	(23)	20	-	59,856
Investment income	-	(83)	(1,714)	-	(1,797)
Equity in net loss of consolidating affiliates	683,376	-	-	(683,376)	-
	687,066	1,648,497	302,234	(708,904)	1,928,893
Loss from continuing operations before income taxes	(687,066)	(251,575)	(110,352)	683,376	(365,617)
Provision (benefit) for income taxes	(1,453)	284,480	603	-	283,630
Loss from continuing operations	(685,613)	(536,055)	(110,955)	683,376	(649,247)
Income (loss) from discontinued operations, net of income taxes	-	(26,852)	4,792	-	(22,060)
Net loss	(685,613)	(562,907)	(106,163)	683,376	(671,307)
Earnings attributable to noncontrolling interests:					
Continuing operations	-	-	(9,574)	-	(9,574)
Discontinued operations	-	-	(4,732)	-	(4,732)

	-	-	(14,306)	-	(14,306)
Loss attributable to Kindred	$(685,613)	$(562,907)	$ (120,469)	$ 683,376	$(685,613)
Comprehensive loss	$(685,055)	$(562,907)	$ (106,849)	$ 684,062	$(670,749)
Comprehensive loss attributable to Kindred	$(685,055)	$(562,907)	$ (121,155)	$ 684,062	$(685,055)

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

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

	Nine months ended September 30, 2017				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$-	$4,042,394	$ 585,251	$ (76,804)	$4,550,841
Salaries, wages and benefits	-	2,309,712	194,362	-	2,504,074
Supplies	-	201,339	29,890	-	231,229
Building rent	-	153,688	40,251	-	193,939
Equipment rent	-	22,463	3,822	-	26,285
Other operating expenses	-	455,028	41,906	-	496,934
General and administrative expenses	-	696,849	180,448	(76,804)	800,493
Other income	-	(839)	(2,056)	-	(2,895)
Litigation contingency expense	-	4,000	-	-	4,000
Impairment charges	-	136,303	-	-	136,303
Restructuring charges	-	30,970	586	-	31,556
Depreciation and amortization	-	73,048	7,231	-	80,279
Management fees	-	(8,160)	8,160	-	-
Intercompany interest (income) expense from affiliates	(185,148)	162,275	22,873	-	-
Interest expense (income)	181,890	(657)	42	-	181,275
Investment income	-	(213)	(3,229)	-	(3,442)
Equity in net loss of consolidating affiliates	513,910	-	-	(513,910)	-
	510,652	4,235,806	524,286	(590,714)	4,680,030
Income (loss) from continuing operations before income taxes	(510,652)	(193,412)	60,965	513,910	(129,189)
Provision (benefit) for income taxes	-	(19,800)	4,693	-	(15,107)
Income (loss) from continuing operations	(510,652)	(173,612)	56,272	513,910	(114,082)
Discontinued operations, net of income taxes:					
Income (loss) from operations	-	(14,430)	12,559	-	(1,871)
Loss on divestiture of operations	-	(349,868)	-	-	(349,868)
Income (loss) from discontinued operations	-	(364,298)	12,559	-	(351,739)
Net income (loss)	(510,652)	(537,910)	68,831	513,910	(465,821)

Earnings attributable to noncontrolling interests:					
Continuing operations	-	-	(32,234)	-	(32,234)
Discontinued operations	-	-	(12,597)	-	(12,597)
	-	-	(44,831)	-	(44,831)
Income (loss) attributable to Kindred	$ (510,652)	$ (537,910)	$ 24,000	$ 513,910	$ (510,652)
Comprehensive income (loss)	$ (509,296)	$ (537,910)	$ 68,584	$ 514,157	$ (464,465)
Comprehensive income (loss) attributable to Kindred	$ (509,296)	$ (537,910)	$ 23,753	$ 514,157	$ (509,296)

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

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

	Nine months ended September 30, 2016				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Revenues	$ -	$ 4,271,040	$ 580,358	$ (76,585)	$ 4,774,813
Salaries, wages and benefits	-	2,361,057	184,974	-	2,546,031
Supplies	-	230,968	32,711	-	263,679
Building rent	-	158,593	41,363	-	199,956
Equipment rent	-	26,919	4,361	-	31,280
Other operating expenses	-	455,057	45,730	-	500,787
General and administrative expenses	-	737,436	188,094	(76,585)	848,945
Other income	-	(220)	(2,459)	-	(2,679)
Litigation contingency expense	-	2,840	-	-	2,840
Impairment charges	-	186,951	124,244	-	311,195
Restructuring charges	-	83,018	1,195	-	84,213
Depreciation and amortization	-	92,971	6,776	-	99,747
Management fees	-	(7,003)	7,003	-	-
Intercompany interest (income) expense from affiliates	(166,673)	131,532	35,141	-	-
Interest expense (income)	175,372	(53)	79	-	175,398
Investment income	-	(276)	(2,243)	-	(2,519)
Equity in net loss of consolidating affiliates	643,548	-	-	(643,548)	-
	652,247	4,459,790	666,969	(720,133)	5,058,873
Loss from continuing operations before income taxes	(652,247)	(188,750)	(86,611)	643,548	(284,060)
Provision (benefit) for income taxes	(3,424)	316,205	1,325	-	314,106
Loss from continuing operations	(648,823)	(504,955)	(87,936)	643,548	(598,166)
Discontinued operations, net of income taxes:					
Income (loss) from operations	-	(24,644)	14,155	-	(10,489)
Gain on divestiture of operations	-	179	-	-	179
Income (loss) from discontinued operations	-	(24,465)	14,155	-	(10,310)
Net loss	(648,823)	(529,420)	(73,781)	643,548	(608,476)

Earnings attributable to noncontrolling interests:					
Continuing operations	-	-	(26,272)	-	(26,272)
Discontinued operations	-	-	(14,075)	-	(14,075)
	-	-	(40,347)	-	(40,347)
Loss attributable to Kindred	$(648,823)	$(529,420)	$(114,128)	$643,548	$(648,823)
Comprehensive loss	$(650,525)	$(529,420)	$(73,613)	$643,380	$(610,178)
Comprehensive loss attributable to Kindred	$(650,525)	$(529,420)	$(113,960)	$643,380	$(650,525)

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Balance Sheet

	As of September 30, 2017				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ -	$ 29,061	$ 101,303	$ -	$ 130,364
Insurance subsidiary investments	-	-	98,079	-	98,079
Accounts receivable, net	-	1,079,976	138,224	-	1,218,200
Inventories	-	17,456	4,035	-	21,491
Income taxes	-	3,476	1,507	-	4,983
Assets held for sale	-	78,324	727	-	79,051
Other	-	51,126	15,337	-	66,463
	-	1,259,419	359,212	-	1,618,631
Property and equipment, net	-	675,343	54,517	-	729,860
Goodwill	-	1,974,760	450,071	-	2,424,831
Intangible assets, net	-	566,557	45,720	-	612,277
Insurance subsidiary investments	-	-	184,417	-	184,417
Intercompany	4,917,830	-	-	(4,917,830)	-
Deferred tax assets	-	-	7,311	(7,311)	-
Other	6,803	133,771	161,161	-	301,735
	$ 4,924,633	$ 4,609,850	$ 1,262,409	$ (4,925,141)	$ 5,871,751
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$ -	$ 122,828	$ 53,525	$ -	$ 176,353
Salaries, wages and other compensation	-	315,144	55,069	-	370,213
Due to third party payors	-	48,739	52	-	48,791
Professional liability risks	-	3,437	52,231	-	55,668
Accrued lease termination fees	-	109,113	-	-	109,113
Other accrued liabilities	54,079	188,123	22,755	-	264,957
Long-term debt due within one year	17,210	-	1,037	-	18,247
	71,289	787,384	184,669	-	1,043,342

Long-term debt	3,302,787	-	149	-	3,302,936
Intercompany/deficiency in earnings of consolidated subsidiaries	1,246,599	4,352,955	564,875	(6,164,429)	-
Professional liability risks	-	90,716	224,606	-	315,322
Deferred tax liabilities	-	189,376	-	(7,311)	182,065
Deferred credits and other liabilities	-	357,877	139,559	-	497,436
Commitments and contingencies					
Equity (deficit):					
Stockholders' equity (deficit)	303,958	(1,168,458)	(78,141)	1,246,599	303,958
Noncontrolling interests	-	-	226,692	-	226,692
	303,958	(1,168,458)	148,551	1,246,599	530,650
	$4,924,633	$4,609,850	$ 1,262,409	$ (4,925,141)	$ 5,871,751

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Balance Sheet (Continued)

	As of December 31, 2016				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	$ -	$ 25,767	$ 111,294	$ -	$ 137,061
Insurance subsidiary investments	-	-	108,966	-	108,966
Accounts receivable, net	-	1,022,850	149,228	-	1,172,078
Inventories	-	18,290	4,148	-	22,438
Income taxes	-	9,023	1,044	-	10,067
Assets held for sale	-	278,689	10,761	-	289,450
Other	-	56,054	7,639	-	63,693
	-	1,410,673	393,080	-	1,803,753
Property and equipment, net	-	557,761	60,859	-	618,620
Goodwill	-	1,977,003	450,071	-	2,427,074
Intangible assets, net	-	723,760	46,348	-	770,108
Insurance subsidiary investments	-	-	204,929	-	204,929
Intercompany	4,850,517	-	-	(4,850,517)	-
Deferred tax assets	-	-	7,224	(7,224)	-
Other	10,123	116,305	161,812	-	288,240
	$ 4,860,640	$ 4,785,502	$ 1,324,323	$ (4,857,741)	$ 6,112,724
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$ -	$ 112,286	$ 91,639	$ -	$ 203,925
Salaries, wages and other compensation	-	339,600	57,886	-	397,486
Due to third party payors	-	41,320	-	-	41,320
Professional liability risks	-	3,401	61,883	-	65,284
Accrued lease termination fees	-	5,224	-	-	5,224
Other accrued liabilities	74,634	170,476	19,402	-	264,512
Long-term debt due within one year	26,406	-	1,571	-	27,977
	101,040	672,307	232,381	-	1,005,728

Long-term debt	3,214,607	-	455	-	3,215,062
Intercompany/deficiency in earnings of					
consolidated subsidiaries	732,442	4,281,685	568,832	(5,582,959)	-
Professional liability risks	-	78,124	217,187	-	295,311
Deferred tax liabilities	-	209,032	-	(7,224)	201,808
Deferred credits and other liabilities	-	219,701	133,593	-	353,294
Commitments and contingencies					
Equity (deficit):					
Stockholders' equity (deficit)	812,551	(675,347)	(57,095)	732,442	812,551
Noncontrolling interests	-	-	228,970	-	228,970
	812,551	(675,347)	171,875	732,442	1,041,521
	$4,860,640	$4,785,502	$ 1,324,323	$ (4,857,741)	$ 6,112,724

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Cash Flows

	Three months ended September 30, 2017				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by (used in) operating activities	$ (12,276)	$ (16,014)	$ 36,771	$ -	$ 8,481
Cash flows from investing activities:					
Routine capital expenditures	-	(15,972)	(491)	-	(16,463)
Development capital expenditures	-	(6,415)	-	-	(6,415)
Sale of assets	-	5,494	-	-	5,494
Purchase of insurance subsidiary investments	-	-	(18,047)	-	(18,047)
Sale of insurance subsidiary investments	-	-	50,087	-	50,087
Net change in insurance subsidiary cash and cash equivalents	-	-	(10,053)	-	(10,053)
Net change in other investments	-	5,088	-	-	5,088
Return of contributed surplus from Cornerstone	-	30,000	-	(30,000)	-
Other	-	(81)	-	-	(81)
Net cash provided by investing activities	-	18,114	21,496	(30,000)	9,610
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	426,700	-	-	-	426,700
Repayment of borrowings under revolving credit	(427,300)	-	-	-	(427,300)
Repayment of term loan	(3,508)	-	-	-	(3,508)
Payment of other long-term debt	-	-	(217)	-	(217)
Payment of deferred financing costs	(170)	-	-	-	(170)
Payment of dividend for Mandatory Redeemable Preferred Stock	(3,120)	-	-	-	(3,120)
Distributions to noncontrolling interests	-	-	(10,071)	-	(10,071)
Payroll tax payments for equity awards issuance	-	(88)	-	-	(88)
	-	-	(30,000)	30,000	-

Return of contributed surplus from Cornerstone					
Net change in intercompany accounts	19,674	(3,490)	(16,184)	-	-
Net cash provided by (used in) financing activities	12,276	(3,578)	(56,472)	30,000	(17,774)
Change in cash and cash equivalents	-	(1,478)	1,795	-	317
Cash and cash equivalents at beginning of period	-	30,539	99,508	-	130,047
Cash and cash equivalents at end of period	$-	$ 29,061	$ 101,303	$ -	$ 130,364

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KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Cash Flows (Continued)

	Three months ended September 30, 2016				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by (used in) operating activities	$(16,518)	$ 31,382	$ 21,503	$ -	$ 36,367
Cash flows from investing activities:					
Routine capital expenditures	-	(19,562)	(2,311)	-	(21,873)
Development capital expenditures	-	(3,413)	(4,973)	-	(8,386)
Acquisitions, net of cash acquired	-	(49,329)	-	-	(49,329)
Sale of assets	-	3,739	-	-	3,739
Purchase of insurance subsidiary investments	-	-	(22,427)	-	(22,427)
Sale of insurance subsidiary investments	-	-	31,875	-	31,875
Net change in insurance subsidiary cash and cash equivalents	-	-	(14,680)	-	(14,680)
Net change in other investments	-	(63)	114	-	51
Other	-	(150)	-	-	(150)
Net cash used in investing activities	-	(68,778)	(12,402)	-	(81,180)
Cash flows from financing activities:					
Proceeds from borrowings under revolving credit	489,200	-	-	-	489,200
Repayment of borrowings under revolving credit	(388,100)	-	-	-	(388,100)
Repayment of term loan	(3,508)	-	-	-	(3,508)
Repayment of other long-term debt	-	-	(276)	-	(276)
Payment of deferred financing costs	(50)	-	-	-	(50)
Payment of dividend for Mandatory Redeemable Preferred Stock	(2,904)	-	-	-	(2,904)
Dividends paid	(10,224)	-	-	-	(10,224)
Contributions made by noncontrolling interests	-	-	4,993	-	4,993
Distributions to noncontrolling interests	-	-	(4,694)	-	(4,694)
	-	(250)	-	-	(250)

Payroll tax payments for equity awards issuance					
Net change in intercompany accounts	(67,896)	46,232	21,664	-	-
Net cash provided by financing activities	16,518	45,982	21,687	-	84,187
Change in cash and cash equivalents	-	8,586	30,788	-	39,374
Cash and cash equivalents at beginning of period	-	24,037	76,019	-	100,056
Cash and cash equivalent at end of period	$-	$ 32,623	$ 106,807	$ -	$ 139,430

KINDRED HEALTHCARE, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE 16 – CONDENSED CONSOLIDATING FINANCIAL INFORMATION (Continued)

Condensed Consolidating Statement of Cash Flows (Continued)

	Nine months ended September 30, 2017				
(In thousands)	Parent company/ issuer	Guarantor subsidiaries	Non-guarantor subsidiaries	Consolidating and eliminating adjustments	Consolidated
Net cash provided by (used in) operating activities	$(9,488)	$ (39,244)	$ 57,244	$ -	$ 8,512
Cash flows from investing activities:					
Routine capital expenditures	-				