

KINDRED HEALTHCARE INC
Form 8-K
August 05, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): August 4, 2004

KINDRED HEALTHCARE, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

001-14057
(Commission File Number)

61-1323993
(IRS Employer
Identification No.)

680 South Fourth Street

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Louisville, Kentucky

(Address of principal executive offices)

40202-2412

(Zip Code)

Registrant's telephone number, including area code: (502) 596-7300

Not Applicable

(Former name or former address, if changed since last report)

Item 9. Regulation FD Disclosure.

Kindred Healthcare, Inc. (the Company) has announced revised earnings expectations for its continuing operations for fiscal 2004. Revenues for 2004 are expected to approximate \$3.6 billion. Operating income, or earnings before interest, income taxes, depreciation and rents, is expected to range from \$503 million to \$508 million. Professional liability costs for 2004 are expected to range from \$85 million to \$90 million, while depreciation and net interest costs for 2004 are expected to approximate \$100 million. Net income from continuing operations is expected between \$80 million and \$83 million, or \$1.88 to \$1.95 per diluted share (based upon diluted shares of 42.6 million). For 2003, the Company reported revenues of \$3.3 billion, operating income of \$426 million and net income from continuing operations of \$49.5 million or \$1.41 per diluted share (based upon diluted shares of 35 million).

The Company's previous 2004 earnings guidance for continuing operations indicated a revenue range of \$3.5 billion to \$3.6 billion, operating income between \$484 million and \$494 million, and net income ranging from \$68 million to \$75 million or \$1.58 to \$1.74 per diluted share (based on diluted shares of 43 million). The prior 2004 guidance also included a range of professional liability costs of \$90 million to \$100 million and a depreciation and net interest cost estimate of \$100 million.

In addition to the risk factors set forth under Forward Looking Statements, the Company's 2004 earnings guidance assumes the continued stabilization of professional liability costs and the successful completion of its development plans for additional hospitals and institutional pharmacy locations and the related start-up losses associated with these new projects. Fiscal 2004 earnings estimates also assume continued progress in the Company's transition of its long-term acute care hospitals to the new Medicare prospective payment system and include the revised Medicare payment rates issued in May 2004 that became effective for patient discharges after July 1, 2004. Management also expects that there will be continued pressure on non-government hospital payment rates as it continues to implement its care management programs for all patients and length of stay declines.

Recent Developments

The Company has contracts with non-Kindred short-term acute care hospitals to operate long-term acute care hospitals within the host hospital. Under these arrangements, the Company leases space and purchases a limited amount of ancillary services from the host hospital and provides it with the option to discharge a portion of its clinically appropriate patients into the care of the Company's hospital. These hospitals-in-hospitals (HIHs) also receive patients from general short-term acute care hospitals other than the host hospital. At June 30, 2004, the Company operated 59 free-standing hospitals (5,019 licensed beds) and 11 HIHs (455 licensed beds).

On August 2, 2004, the Centers for Medicare and Medicaid Services (CMS) announced regulatory changes applicable to long-term acute care hospitals that are operated as an HIH. Once fully phased in, the new rules generally limit Medicare payments to the HIH if the admissions to the HIH from the host hospital exceed 25% of the total Medicare discharges for the HIH's cost reporting period. There are limited exceptions for admissions from rural and urban medical centers.

The Company is continuing to evaluate the impact of the final regulations on its operations and is awaiting additional payment instructions to be issued by CMS. At this time, the Company does not believe that the new rules will significantly impact its ongoing operations since only 8% of its existing hospital licensed beds would be subject to the new rules. For the second quarter of 2004, the Company's HIHs generated revenues of approximately \$23 million, operating income of approximately \$5 million and pretax income of approximately \$2 million. The Company also is considering the impact of the final regulations on its HIH development activities.

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Forward Looking Statements

This Form 8-K includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements regarding the Company's expected future financial position, results of operations, cash flows, financing plans, business strategy, budgets, capital expenditures, competitive positions, growth opportunities, plans and objectives of management and statements containing the words such as anticipate, approximate, believe, plan, estimate, expect, project, should, will, intend, may and other similar expressions, are forward-looking statements.

Such forward-looking statements are inherently uncertain, and stockholders and other potential investors must recognize that actual results may differ materially from the Company's expectations as a result of a variety of factors, including, without limitation, those discussed below. Such forward-looking statements are based on management's current expectations and include known and unknown risks, uncertainties and other factors, many of which the Company

is unable to predict or control, that may cause the Company's actual results or performance to differ materially from any future results or performance expressed or implied by such forward-looking statements. These statements involve risks, uncertainties and other factors discussed below and detailed from time to time in the Company's filings with the Securities and Exchange Commission.

Factors that may affect the Company's plans or results include, without limitation, (a) the Company's ability to operate pursuant to the terms of its debt obligations and its master lease agreements with Ventas, Inc.; (b) the Company's ability to meet its rental and debt service obligations; (c) adverse developments with respect to the Company's results of operations or liquidity; (d) the Company's ability to attract and retain key executives and other healthcare personnel; (e) increased operating costs due to shortages in qualified nurses and other healthcare personnel; (f) the effects of healthcare reform and government regulations, interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare industry; (g) changes in the reimbursement rates or methods of payment from third party payors, including the Medicare and Medicaid programs, and changes arising from the Medicare prospective payment system for long-term acute care hospitals and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, and potential changes in nursing center Medicare reimbursement resulting from revised resource utilization grouping payments; (h) national and regional economic conditions, including their effect on the availability and cost of labor, materials and other services; (i) the Company's ability to control costs, including labor and employee benefit costs; (j) the Company's ability to comply with the terms of its Corporate Integrity Agreement; (k) the Company's ability to successfully pursue its development activities and integrate operations of new facilities; (l) the increase in the costs of defending and insuring against alleged professional liability claims and the Company's ability to predict the estimated costs related to such claims; (m) the Company's ability to successfully reduce (by divestiture of operations or otherwise) its exposure to professional liability claims; and (n) the Company's ability to successfully dispose of unprofitable facilities. Many of these factors are beyond the Company's control. The Company cautions investors that any forward-looking statements made by the Company are not guarantees of future performance. The Company disclaims any obligation to update any such factors or to announce publicly the results of any revisions to any of the forward-looking statements to reflect future events or developments.

Item 12. Results of Operations and Financial Condition.

On August 4, 2004, the Company issued a press release announcing its financial results for the quarter ended June 30, 2004. The press release, dated August 4, 2004, is attached as Annex A to this Form 8-K. On August 4, 2004, the Company also included the press release on its website at www.kindredhealthcare.com.

Annex A is incorporated herein by reference and has been furnished, not filed.

SIGNATURES

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

Date: August 5, 2004

By: /s/ Richard A. Lechleiter

Richard A. Lechleiter
Senior Vice President and Chief Financial Officer

[Kindred Logo appears here]

Contact: Richard A. Lechleiter
Senior Vice President and
Chief Financial Officer
(502) 596-7734

KINDRED HEALTHCARE ANNOUNCES SECOND QUARTER RESULTS

Fiscal 2004 Earnings Guidance Increased

Operating Income Range Increased to \$503 - \$508 Million from \$484 - \$494 Million

Diluted Earnings per Share Range Increased to \$1.88 - \$1.95 from \$1.58 - \$1.74

Company Announces Additional Development Activities in the Quarter

LOUISVILLE, Ky. (August 4, 2004) Kindred Healthcare, Inc. (the Company) (NASDAQ:KIND) today announced its operating results for the second quarter ended June 30, 2004. Share and per share data for all periods presented have been adjusted retroactively to reflect the 2-for-1 stock split that took effect in May 2004.

Continuing Operations

Revenues for the second quarter of 2004 rose 10% to \$897 million compared to \$814 million in the year-earlier period. Net income from continuing operations totaled \$24.3 million or \$0.58 per diluted share for the second quarter of 2004 compared to \$13.2 million or \$0.38 per diluted share in the second quarter last year.

Operating results in the second quarter of 2004 included certain items that, in the aggregate, increased net income by approximately \$5.8 million or \$0.14 per diluted share. Hospital operating results included pretax income of \$3.9 million (\$2.4 million net of income taxes) related to settlements of prior year Medicare cost reports. Nursing center operating results included pretax income of \$5.9 million (\$3.6 million net of

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income taxes) related to retroactive Medicaid rate increases in North Carolina, approximately one-half of which related to the fourth quarter of 2003 and one-half of which related to the first quarter of 2004. As previously announced, interest expense in the second quarter of 2004 included a pretax charge of \$1.2 million (\$0.7 million net of income taxes) resulting from the refinancing of the Company's credit facilities in June. Second quarter 2004 pretax income also included \$0.6 million of investment income resulting from the recovery of certain surety deposits and a favorable adjustment of \$0.3 million related to accrued reorganization costs (in the aggregate, \$0.5 million net of income taxes).

During the second quarter of 2004, the Company continued to make progress in stabilizing its professional liability costs. These costs aggregated \$20.6 million in the second quarter of 2004 compared to \$20.9 million in the second quarter of 2003 and \$22.9 million in the first quarter of 2004.

The Company also reported improved liquidity during the second quarter of 2004. Net positive cash flows aggregated \$47 million in the second quarter after the repayment of approximately \$39 million of long-term debt.

For the six months ended June 30, 2004, revenues increased 9% to \$1.8 billion from \$1.6 billion in the first half of 2003. Net income from continuing operations totaled \$40.5 million or \$0.96 per diluted share for the first six months of 2004 compared to \$15.7 million or \$0.45 per diluted share in the same period a year ago.

Revised Earnings Guidance for 2004

The Company also increased its fiscal 2004 earnings expectations for its continuing operations. Revenues for 2004 are expected to approximate \$3.6 billion. Operating income, or earnings before interest, income taxes, depreciation and rents, is expected to range from \$503 million to \$508 million. Professional liability costs for 2004 are expected to range from \$85 million to \$90 million, while depreciation and net interest costs for 2004 are expected to approximate \$100 million. Net income from continuing operations is expected between \$80 million and \$83 million, or \$1.88 to \$1.95 per diluted share (based upon diluted shares of 42.6 million). For 2003, the Company reported revenues of \$3.3 billion, operating income of \$426 million and net income from continuing operations of \$49.5 million or \$1.41 per diluted share (based upon diluted shares of 35 million).

The Company's previous 2004 earnings guidance for continuing operations indicated a revenue range of \$3.5 billion to \$3.6 billion, operating income between \$484 million and \$494 million, and net income ranging from \$68 million to \$75 million or \$1.58 to \$1.74 per diluted share (based on diluted shares of 43 million). The prior 2004 guidance also included a range of professional liability costs of \$90 million to \$100 million and a depreciation and net interest cost estimate of \$100 million.

In addition to the risk factors set forth under *Forward Looking Statements*, the Company's 2004 earnings guidance assumes the continued stabilization of professional liability costs and the successful completion of its development plans for additional hospitals and institutional pharmacy locations and the related start-up losses associated with these new projects. Fiscal 2004 earnings estimates also assume continued progress in the Company's transition of its long-term acute care hospitals to the new Medicare prospective payment system and include the revised Medicare payment rates issued in May 2004 that became effective for patient discharges after July 1, 2004. Management also expects that there will be continued pressure on non-government hospital payment rates as it continues to implement its care management programs for all patients and length of stay declines.

Management Commentary

Kindred President and Chief Executive Officer Paul J. Diaz commented, "We're pleased with the execution of our strategic operating plan in each of our divisions through the first half of this year as we continue to focus on our patients and employees. This quarter's solid performance represents another step toward our goal of delivering more consistent and predictable operating results for our shareholders."

Mr. Diaz further commented, "We made progress on several fronts during the second quarter. In our hospital division, we reported same-store admissions growth of 5% compared to the second quarter of last year while also continuing to improve our operating efficiencies and reduce length of stay. Additionally, the new payment rates applicable to our in-house Medicare patients at June 30, 2004 increased our second quarter hospital revenues by approximately \$5 million. In our health services division, continued focus on quality and customer service contributed to more stable operating results and improving professional liability cost trends. Our *Peoplefirst* Rehabilitation business, in only its second quarter of operation as a separate division, reported solid results as we continue to make strides toward improved therapist recruitment and retention. Finally, our KPS Pharmacy customer base continues to grow, with total licensed customer beds at June 30 up over 14% from a year ago and revenues in the quarter increasing 30% compared to last year."

Mr. Diaz also commented on the Company's development activities. Over the past twelve months, we have added seven hospitals with 370 licensed beds, including two hospitals in the second quarter through the acquisition of a free-standing 100-bed hospital in Modesto, California and the opening of a new 45-bed hospital-in-hospital in Dover, New Jersey. In the second half of 2004, we expect to open two to three additional hospitals. We also will spend approximately \$20 million to build a new free-standing 58-bed hospital in Sacramento, California that will replace our existing 39-bed facility.

The Company also announced that it will open five new institutional pharmacies in the second half of 2004. Mr. Diaz commented, Continued improvement in our KPS Pharmacy operations and an expanding customer base will allow us to open these sites in new markets with an average of 800 to 900 beds per site. In addition, we also are excited about a new arrangement in which KPS Pharmacy and Peoplefirst Rehabilitation began providing services to 65 of our hospitals on July 1, 2004. This reorganization will provide our hospital rehabilitation and pharmacy departments the additional resources necessary to support our admissions growth and better manage costs under the Medicare prospective payment system. The establishment of this infrastructure also will allow KPS Pharmacy and Peoplefirst Rehabilitation, over time, to service additional third party hospital customers and expand these businesses.

With respect to the Company's liquidity and financial position, Mr. Diaz noted, We made outstanding progress in improving our overall cash flows during the second quarter. In addition, the completion of our new \$300 million revolving credit facility in June will provide the financial flexibility to look more aggressively at acquisitions and execute our strategic growth plan of adding new hospitals and institutional pharmacies to our portfolio.

Discontinued Operations

Net losses from discontinued operations totaled \$1.4 million or \$0.03 per diluted share in the second quarter of 2004 compared to net losses of \$20.6 million or \$0.59 per diluted share in the second quarter of 2003. For the six months ended June 30, 2004, net losses from discontinued operations totaled \$3.8 million or \$0.09 per diluted share compared to \$36.2 million or \$1.04 per diluted share in the first half of 2003.

Net losses on the divestiture of discontinued operations totaled \$1.1 million or \$0.03 per diluted share for both the second quarter and six months ended June 30, 2004 compared to \$36.0 million or \$1.04 per diluted share for both the second quarter and six months ended June 30, 2003.

Recent Developments

The Company has contracts with non-Kindred short-term acute care hospitals to operate long-term acute care hospitals within the host hospital. Under these arrangements, the Company leases space and purchases a limited amount of ancillary services from the host hospital and provides it with the option to discharge a portion of its clinically appropriate patients into the care of the Company's hospital. These hospitals-in-hospitals (HIHs) also receive patients from general short-term acute care hospitals other than the host hospital. At June 30, 2004, the Company operated 59 free-standing hospitals (5,019 licensed beds) and 11 HIHs (455 licensed beds).

On August 2, 2004, the Centers for Medicare and Medicaid Services (CMS) announced regulatory changes applicable to long-term acute care hospitals that are operated as an HIH. Once fully phased in, the new rules generally limit Medicare payments to the HIH if the admissions to the HIH from the host hospital exceed 25% of the total Medicare discharges for the HIH's cost reporting period. There are limited exceptions for admissions from rural and urban medical centers.

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The Company is continuing to evaluate the impact of the final regulations on its operations and is awaiting additional payment instructions to be issued by CMS. At this time, the Company does not believe that the new rules will significantly impact its ongoing operations since only 8% of its existing hospital licensed beds would be subject to the new rules. For the second quarter of 2004, the Company's HHHs generated revenues of approximately \$23 million, operating income of approximately \$5 million and pretax income of approximately \$2 million. The Company also is considering the impact of the final regulations on its HHH development activities.

Forward Looking Statements

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

Such forward-looking statements are inherently uncertain, and stockholders and other potential investors must recognize that actual results may differ materially from the Company's expectations as a

result of a variety of factors, including, without limitation, those discussed below. Such forward-looking statements are based on management's current expectations and include known and unknown risks, uncertainties and other factors, many of which the Company is unable to predict or control, that may cause the Company's actual results or performance to differ materially from any future results or performance expressed or implied by such forward-looking statements. These statements involve risks, uncertainties and other factors discussed below and detailed from time to time in the Company's filings with the Securities and Exchange Commission.

Factors that may affect the Company's plans or results include, without limitation, (a) the Company's ability to operate pursuant to the terms of its debt obligations and its master lease agreements with Ventas, Inc. (NYSE:VTR); (b) the Company's ability to meet its rental and debt service obligations; (c) adverse developments with respect to the Company's results of operations or liquidity; (d) the Company's ability to attract and retain key executives and other healthcare personnel; (e) increased operating costs due to shortages in qualified nurses and other healthcare personnel; (f) the effects of healthcare reform and government regulations, interpretation of regulations and changes in the nature and enforcement of regulations governing the healthcare industry; (g) changes in the reimbursement rates or methods of payment from third party payors, including the Medicare and Medicaid programs, and changes arising from the Medicare prospective payment system for long-term acute care hospitals and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, and potential changes in nursing center Medicare reimbursement resulting from revised resource utilization grouping payments; (h) national and regional economic conditions, including their effect on the availability and cost of labor, materials and other services; (i) the Company's ability to control costs, including labor and employee benefit costs; (j) the Company's ability to comply with the terms of its Corporate Integrity Agreement; (k) the Company's ability to successfully pursue its development activities and integrate operations of new facilities; (l) the increase in the costs of defending and insuring against alleged professional liability claims and the Company's ability to predict the estimated costs related to such claims; (m) the Company's ability to successfully reduce (by divestiture of operations or otherwise) its exposure to professional liability claims; and (n) the Company's ability to successfully dispose of unprofitable facilities. Many of these factors are beyond the Company's control. The Company cautions investors that any forward-looking statements made by the Company are not guarantees of future performance. The Company disclaims any obligation to update any such factors or to announce publicly the results of any revisions to any of the forward-looking statements to reflect future events or developments.

Kindred Healthcare, Inc. is a national healthcare services company operating hospitals, nursing centers, institutional pharmacies and a contract rehabilitation services business.

KINDRED HEALTHCARE, INC.

Financial Summary

(Unaudited)

(In thousands, except per share amounts)

| | Three months ended | | Six months ended | |
|--|--------------------|-------------|------------------|--------------|
| | June 30, | | June 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| Revenues | \$ 897,461 | \$ 813,848 | \$ 1,768,723 | \$ 1,616,006 |
| Income from continuing operations | \$ 24,220 | \$ 13,144 | \$ 40,495 | \$ 15,655 |
| Discontinued operations, net of income taxes: | | | | |
| Loss from operations | (1,388) | (20,555) | (3,823) | (36,190) |
| Loss on divestiture of operations | (1,063) | (36,019) | (1,063) | (36,019) |
| Net income (loss) | \$ 21,769 | \$ (43,430) | \$ 35,609 | \$ (56,554) |
| Earnings (loss) per common share: | | | | |
| Basic: | | | | |
| Income from continuing operations | \$ 0.68 | \$ 0.38 | \$ 1.14 | \$ 0.45 |
| Discontinued operations: | | | | |
| Loss from operations | (0.04) | (0.59) | (0.11) | (1.04) |
| Loss on divestiture of operations | (0.03) | (1.04) | (0.03) | (1.04) |
| Net income (loss) | \$ 0.61 | \$ (1.25) | \$ 1.00 | \$ (1.63) |
| Diluted: | | | | |
| Income from continuing operations | \$ 0.58 | \$ 0.38 | \$ 0.96 | \$ 0.45 |
| Discontinued operations: | | | | |
| Loss from operations | (0.03) | (0.59) | (0.09) | (1.04) |
| Loss on divestiture of operations | (0.03) | (1.04) | (0.03) | (1.04) |
| Net income (loss) | \$ 0.52 | \$ (1.25) | \$ 0.84 | \$ (1.63) |
| Shares used in computing earnings (loss) per common share: | | | | |
| Basic | 35,536 | 34,813 | 35,475 | 34,784 |
| Diluted | 41,913 | 34,828 | 42,333 | 34,798 |

KINDRED HEALTHCARE, INC.

Condensed Consolidated Statement of Operations

(Unaudited)

(In thousands, except per share amounts)

| | Three months ended | | Six months ended | |
|--|--------------------|-------------|------------------|--------------|
| | June 30, | | June 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| Revenues | \$ 897,461 | \$ 813,848 | \$ 1,768,723 | \$ 1,616,006 |
| Salaries, wages and benefits | 494,154 | 462,320 | 986,225 | 923,072 |
| Supplies | 120,563 | 104,440 | 237,296 | 208,622 |
| Rent | 65,958 | 64,215 | 130,417 | 127,293 |
| Other operating expenses | 150,358 | 140,776 | 295,764 | 287,615 |
| Depreciation | 22,612 | 19,927 | 44,658 | 39,122 |
| Interest expense | 4,714 | 2,992 | 8,370 | 5,880 |
| Investment income | (1,826) | (1,676) | (3,044) | (3,311) |
| | 856,533 | 792,994 | 1,699,686 | 1,588,293 |
| Income from continuing operations before reorganization items and income taxes | 40,928 | 20,854 | 69,037 | 27,713 |
| Reorganization items | (304) | | (304) | |
| Income from continuing operations before income taxes | 41,232 | 20,854 | 69,341 | 27,713 |
| Provision for income taxes | 17,012 | 7,710 | 28,846 | 12,058 |
| Income from continuing operations | 24,220 | 13,144 | 40,495 | 15,655 |
| Discontinued operations, net of income taxes: | | | | |
| Loss from operations | (1,388) | (20,555) | (3,823) | (36,190) |
| Loss on divestiture of operations | (1,063) | (36,019) | (1,063) | (36,019) |
| Net income (loss) | \$ 21,769 | \$ (43,430) | \$ 35,609 | \$ (56,554) |
| Earnings (loss) per common share: | | | | |
| Basic: | | | | |
| Income from continuing operations | \$ 0.68 | \$ 0.38 | \$ 1.14 | \$ 0.45 |
| Discontinued operations: | | | | |
| Loss from operations | (0.04) | (0.59) | (0.11) | (1.04) |
| Loss on divestiture of operations | (0.03) | (1.04) | (0.03) | (1.04) |
| Net income (loss) | \$ 0.61 | \$ (1.25) | \$ 1.00 | \$ (1.63) |
| Diluted: | | | | |
| Income from continuing operations | \$ 0.58 | \$ 0.38 | \$ 0.96 | \$ 0.45 |
| Discontinued operations: | | | | |
| Loss from operations | (0.03) | (0.59) | (0.09) | (1.04) |
| Loss on divestiture of operations | (0.03) | (1.04) | (0.03) | (1.04) |

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| | | | | |
|--|----------------|------------------|----------------|------------------|
| Net income (loss) | <u>\$ 0.52</u> | <u>\$ (1.25)</u> | <u>\$ 0.84</u> | <u>\$ (1.63)</u> |
| Shares used in computing earnings (loss) per common share: | | | | |
| Basic | 35,536 | 34,813 | 35,475 | 34,784 |
| Diluted | 41,913 | 34,828 | 42,333 | 34,798 |

KINDRED HEALTHCARE, INC.**Condensed Consolidated Balance Sheet****(Unaudited)**

(In thousands, except per share amounts)

| | June 30, 2004 | December 31, 2003 |
|---|---------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 65,069 | \$ 66,524 |
| Cash restricted | 6,152 | 7,339 |
| Insurance subsidiary investments | 200,889 | 146,325 |
| Accounts receivable less allowance for loss | 430,804 | 429,304 |
| Inventories | 32,497 | 29,984 |
| Deferred tax assets | 89,836 | 89,836 |
| Assets held for sale | 19,023 | 27,400 |
| Other | 42,160 | 46,375 |
| | <u>886,430</u> | <u>843,087</u> |
| Property and equipment | 713,020 | 671,850 |
| Accumulated depreciation | (234,305) | (193,310) |
| | <u>478,715</u> | <u>478,540</u> |
| Goodwill | 31,417 | 31,417 |
| Insurance subsidiary investments | 55,931 | 74,618 |
| Deferred tax assets | 92,335 | 92,093 |
| Other | 63,307 | 65,659 |
| | <u>\$ 1,608,135</u> | <u>\$ 1,585,414</u> |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 114,157 | \$ 119,087 |
| Salaries, wages and other compensation | 219,509 | 214,113 |
| Due to third party payors | 15,872 | 31,406 |
| Professional liability risks | 72,729 | 83,725 |
| Other accrued liabilities | 82,730 | 88,333 |
| Income taxes | 59,560 | 36,684 |
| Long-term debt due within one year | 4,938 | 4,532 |
| | <u>569,495</u> | <u>577,880</u> |
| Long-term debt | 115,984 | 139,397 |
| Professional liability risks | 226,872 | 212,013 |
| Deferred credits and other liabilities | 56,307 | 58,559 |
| Stockholders equity: | | |
| Common stock, \$0.25 par value; authorized 175,000 shares; issued 36,560 shares June 30, 2004 and 36,340 shares December 31, 2003 | 9,140 | 9,085 |
| Capital in excess of par value | 588,780 | 585,394 |

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| | | |
|---|---------------------|---------------------|
| Deferred compensation | (4,688) | (8,040) |
| Accumulated other comprehensive income (loss) | (142) | 348 |
| Retained earnings | 46,387 | 10,778 |
| | <u>639,477</u> | <u>597,565</u> |
| | <u>\$ 1,608,135</u> | <u>\$ 1,585,414</u> |

KINDRED HEALTHCARE, INC.

Condensed Consolidated Statement of Cash Flows

(Unaudited)

(In thousands)

| | Three months ended | | Six months ended | |
|--|--------------------|-------------|------------------|-------------|
| | June 30, | | June 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| Cash flows from operating activities: | | | | |
| Net income (loss) | \$ 21,769 | \$ (43,430) | \$ 35,609 | \$ (56,554) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | | |
| Depreciation | 22,613 | 20,526 | 44,659 | 40,609 |
| Amortization of deferred compensation costs | 1,535 | 984 | 3,278 | 2,237 |
| Provision for doubtful accounts | 5,134 | 6,678 | 13,250 | 12,966 |
| Loss on divestiture of discontinued operations | 1,063 | 36,019 | 1,063 | 36,019 |
| Reorganization items | (304) | | (304) | |
| Other | 5,040 | 910 | 4,938 | 1,416 |
| Change in operating assets and liabilities: | | | | |
| Accounts receivable | 39,247 | 64,373 | (15,057) | 11,057 |
| Inventories and other assets | 4,221 | 13,193 | (5,247) | 6,806 |
| Accounts payable | (1,625) | 1,202 | (4,809) | (1,796) |
| Income taxes | 13,823 | (7,259) | 23,735 | (12,716) |
| Due to third party payors | (11,797) | 3,104 | (15,534) | 6,655 |
| Other accrued liabilities | 15,543 | 48,231 | 6,481 | 76,166 |
| Net cash provided by operating activities | 116,262 | 144,531 | 92,062 | 122,865 |
| Cash flows from investing activities: | | | | |
| Purchase of property and equipment | (17,657) | (17,477) | (35,538) | (28,042) |
| Acquisition of healthcare facilities | (8,346) | (63,795) | (8,346) | (63,795) |
| Sale of assets | 6,514 | 7,659 | 6,884 | 7,659 |
| Surety bond deposits | 4,402 | | 4,402 | |
| Purchase of insurance subsidiary investments | (4,767) | (88,626) | (14,543) | (119,021) |
| Sale of insurance subsidiary investments | 8,209 | 24,177 | 13,881 | 26,510 |
| Net change in insurance subsidiary cash and cash equivalents | (18,395) | 63,755 | (35,215) | (8,156) |
| Net change in other investments | 2,628 | 2,645 | 4,405 | (2,040) |
| Other | 236 | (1,702) | 374 | (2,035) |
| Net cash used in investing activities | (27,176) | (73,364) | (63,696) | (188,920) |
| Cash flows from financing activities: | | | | |
| Net change in revolving credit borrowings | 63,100 | | 80,000 | |
| Repayment of long-term debt | (101,615) | (116) | (102,647) | (228) |
| Payment of deferred financing costs | (3,355) | (1,276) | (3,355) | (2,872) |
| Issuance of common stock | 3,049 | | 3,516 | |
| Other | (3,023) | 189 | (7,335) | (4,778) |
| Net cash used in financing activities | (41,844) | (1,203) | (29,821) | (7,878) |

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| | | | | |
|--|------------------|-------------------|------------------|-------------------|
| Change in cash and cash equivalents | <u>47,242</u> | <u>69,964</u> | <u>(1,455)</u> | <u>(73,933)</u> |
| Cash and cash equivalents at beginning of period | <u>17,827</u> | <u>100,173</u> | <u>66,524</u> | <u>244,070</u> |
| Cash and cash equivalents at end of period | <u>\$ 65,069</u> | <u>\$ 170,137</u> | <u>\$ 65,069</u> | <u>\$ 170,137</u> |

KINDRED HEALTHCARE, INC.

Condensed Consolidated Statement of Operations

(Unaudited)

(In thousands, except per share amounts)

| | 2003 Quarters | | | | 2004 Quarters | |
|--|---------------|-------------|------------|-------------|---------------|------------|
| | First | Second | Third | Fourth | First | Second |
| Revenues | \$ 802,158 | \$ 813,848 | \$ 837,035 | \$ 830,978 | \$ 871,262 | \$ 897,461 |
| Salaries, wages and benefits | 460,752 | 462,320 | 469,112 | 473,263 | 492,071 | 494,154 |
| Supplies | 104,182 | 104,440 | 107,701 | 113,293 | 116,733 | 120,563 |
| Rent | 63,078 | 64,215 | 64,783 | 64,230 | 64,459 | 65,958 |
| Other operating expenses | 146,839 | 140,776 | 144,368 | 131,524 | 145,406 | 150,358 |
| Depreciation | 19,195 | 19,927 | 20,407 | 21,328 | 22,046 | 22,612 |
| Interest expense | 2,888 | 2,992 | 1,054 | 3,388 | 3,656 | 4,714 |
| Investment income | (1,635) | (1,676) | (1,333) | (1,491) | (1,218) | (1,826) |
| | 795,299 | 792,994 | 806,092 | 805,535 | 843,153 | 856,533 |
| Income from continuing operations before reorganization items and income taxes | 6,859 | 20,854 | 30,943 | 25,443 | 28,109 | 40,928 |
| Reorganization items | | | | (1,010) | | (304) |
| Income from continuing operations before income taxes | 6,859 | 20,854 | 30,943 | 26,453 | 28,109 | 41,232 |
| Provision for income taxes | 4,348 | 7,710 | 12,629 | 10,968 | 11,834 | 17,012 |
| Income from continuing operations | 2,511 | 13,144 | 18,314 | 15,485 | 16,275 | 24,220 |
| Discontinued operations, net of income taxes: | | | | | | |
| Loss from operations | (15,635) | (20,555) | (5,780) | (3,407) | (2,435) | (1,388) |
| Loss on divestiture of operations | | (36,019) | (827) | (42,567) | | (1,063) |
| Net income (loss) | \$ (13,124) | \$ (43,430) | \$ 11,707 | \$ (30,489) | \$ 13,840 | \$ 21,769 |
| Earnings (loss) per common share: | | | | | | |
| Basic: | | | | | | |
| Income from continuing operations | \$ 0.07 | \$ 0.38 | \$ 0.53 | \$ 0.44 | \$ 0.46 | \$ 0.68 |
| Discontinued operations: | | | | | | |
| Loss from operations | (0.45) | (0.59) | (0.17) | (0.10) | (0.07) | (0.04) |
| Loss on divestiture of operations | | (1.04) | (0.02) | (1.21) | | (0.03) |
| Net income (loss) | \$ (0.38) | \$ (1.25) | \$ 0.34 | \$ (0.87) | \$ 0.39 | \$ 0.61 |
| Diluted: | | | | | | |
| Income from continuing operations | \$ 0.07 | \$ 0.38 | \$ 0.52 | \$ 0.38 | \$ 0.38 | \$ 0.58 |
| Discontinued operations: | | | | | | |
| Loss from operations | (0.45) | (0.59) | (0.17) | (0.08) | (0.06) | (0.03) |
| Loss on divestiture of operations | | (1.04) | (0.02) | (1.05) | | (0.03) |

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| | | | | | | |
|--|-----------|-----------|---------|-----------|---------|---------|
| Net income (loss) | \$ (0.38) | \$ (1.25) | \$ 0.33 | \$ (0.75) | \$ 0.32 | \$ 0.52 |
| Shares used in computing earnings (loss) per common share: | | | | | | |
| Basic | 34,755 | 34,813 | 34,885 | 35,062 | 35,414 | 35,536 |
| Diluted | 34,767 | 34,828 | 35,143 | 40,685 | 42,721 | 41,913 |

KINDRED HEALTHCARE, INC.**Condensed Business Segment Data****(Unaudited)**

(In thousands)

| | 2003 Quarters | | | | 2004 Quarters | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | First | Second | Third | Fourth | First | Second |
| Revenues: | | | | | | |
| Hospital division | \$ 331,862 | \$ 338,360 | \$ 341,368 | \$ 325,619 | \$ 348,648 | \$ 355,312 |
| Health services division (a) | 410,832 | 416,768 | 431,978 | 433,532 | 444,994 | 460,078 |
| Rehabilitation division (a) | 8,502 | 8,795 | 12,065 | 14,121 | 52,699 | 52,588 |
| Pharmacy division | 66,126 | 64,850 | 67,075 | 74,382 | 79,746 | 84,346 |
| | <u>817,322</u> | <u>828,773</u> | <u>852,486</u> | <u>847,654</u> | <u>926,087</u> | <u>952,324</u> |
| Eliminations: | | | | | | |
| Pharmacy | (15,164) | (14,925) | (15,451) | (16,676) | (18,136) | (17,717) |
| Rehabilitation (a) | | | | | (36,689) | (37,146) |
| | <u>(15,164)</u> | <u>(14,925)</u> | <u>(15,451)</u> | <u>(16,676)</u> | <u>(54,825)</u> | <u>(54,863)</u> |
| | <u>\$ 802,158</u> | <u>\$ 813,848</u> | <u>\$ 837,035</u> | <u>\$ 830,978</u> | <u>\$ 871,262</u> | <u>\$ 897,461</u> |
| Income from continuing operations: | | | | | | |
| Operating income (loss): | | | | | | |
| Hospital division | \$ 70,538 | \$ 75,455 | \$ 87,171 | \$ 73,702 | \$ 80,066 | \$ 86,483 |
| Health services division (a) | 43,424 | 57,235 | 54,944 | 64,436 | 49,469 | 62,489 |
| Rehabilitation division (a) | (959) | (750) | 261 | (315) | 8,519 | 7,265 |
| Pharmacy division | 6,702 | 6,133 | 6,150 | 7,508 | 7,609 | 7,729 |
| Corporate: | | | | | | |
| Overhead | (26,713) | (28,354) | (28,670) | (28,898) | (26,834) | (30,356) |
| Insurance subsidiary | (2,607) | (3,407) | (4,002) | (3,535) | (1,777) | (1,224) |
| | <u>(29,320)</u> | <u>(31,761)</u> | <u>(32,672)</u> | <u>(32,433)</u> | <u>(28,611)</u> | <u>(31,580)</u> |
| | <u>90,385</u> | <u>106,312</u> | <u>115,854</u> | <u>112,898</u> | <u>117,052</u> | <u>132,386</u> |
| Reorganization items | | | | 1,010 | | 304 |
| Operating income | <u>90,385</u> | <u>106,312</u> | <u>115,854</u> | <u>113,908</u> | <u>117,052</u> | <u>132,690</u> |
| Rent | (63,078) | (64,215) | (64,783) | (64,230) | (64,459) | (65,958) |
| Depreciation | (19,195) | (19,927) | (20,407) | (21,328) | (22,046) | (22,612) |
| Interest, net | (1,253) | (1,316) | 279 | (1,897) | (2,438) | (2,888) |
| | <u>6,859</u> | <u>20,854</u> | <u>30,943</u> | <u>26,453</u> | <u>28,109</u> | <u>41,232</u> |
| Income from continuing operations before income taxes | <u>6,859</u> | <u>20,854</u> | <u>30,943</u> | <u>26,453</u> | <u>28,109</u> | <u>41,232</u> |
| Provision for income taxes | <u>4,348</u> | <u>7,710</u> | <u>12,629</u> | <u>10,968</u> | <u>11,834</u> | <u>17,012</u> |
| | <u>\$ 2,511</u> | <u>\$ 13,144</u> | <u>\$ 18,314</u> | <u>\$ 15,485</u> | <u>\$ 16,275</u> | <u>\$ 24,220</u> |

(a) Financial data presented for periods prior to January 1, 2004 have not been restated to reflect the new rehabilitation business alignment.

KINDRED HEALTHCARE, INC.

Condensed Business Segment Data (Continued)

(Unaudited)

(In thousands)

| | 2003 Quarters | | | | 2004 Quarters | |
|--|------------------|------------------|------------------|------------------|------------------|------------------|
| | First | Second | Third | Fourth | First | Second |
| Rent: | | | | | | |
| Hospital division | \$ 23,284 | \$ 23,706 | \$ 23,441 | \$ 22,753 | \$ 22,844 | \$ 23,529 |
| Health services division (a) | 39,031 | 39,808 | 40,459 | 40,530 | 40,283 | 40,874 |
| Rehabilitation division (a) | 69 | 95 | 123 | 185 | 611 | 708 |
| Pharmacy division | 630 | 547 | 698 | 703 | 662 | 790 |
| Corporate | 64 | 59 | 62 | 59 | 59 | 57 |
| | <u>\$ 63,078</u> | <u>\$ 64,215</u> | <u>\$ 64,783</u> | <u>\$ 64,230</u> | <u>\$ 64,459</u> | <u>\$ 65,958</u> |
| Depreciation: | | | | | | |
| Hospital division | \$ 7,054 | \$ 7,450 | \$ 7,684 | \$ 8,257 | \$ 8,464 | \$ 8,712 |
| Health services division (a) | 6,373 | 6,569 | 6,688 | 6,740 | 6,893 | 6,951 |
| Rehabilitation division (a) | 16 | 20 | 22 | 25 | 33 | 37 |
| Pharmacy division | 517 | 539 | 561 | 560 | 530 | 583 |
| Corporate | 5,235 | 5,349 | 5,452 | 5,746 | 6,126 | 6,329 |
| | <u>\$ 19,195</u> | <u>\$ 19,927</u> | <u>\$ 20,407</u> | <u>\$ 21,328</u> | <u>\$ 22,046</u> | <u>\$ 22,612</u> |
| Capital expenditures, excluding acquisitions (including discontinued operations): | | | | | | |
| Hospital division | \$ 2,822 | \$ 4,133 | \$ 5,773 | \$ 13,388 | \$ 5,406 | \$ 5,177 |
| Health services division (a) | 3,222 | 6,375 | 9,768 | 9,804 | 8,450 | 6,487 |
| Rehabilitation division (a) | 51 | 47 | 35 | 11 | 47 | 56 |
| Pharmacy division | 616 | 522 | 815 | 2,254 | 773 | 1,075 |
| Corporate: | | | | | | |
| Information systems | 3,207 | 5,992 | 4,071 | 8,223 | 2,651 | 4,033 |
| Other | 647 | 408 | 361 | 1,551 | 554 | 829 |
| | <u>\$ 10,565</u> | <u>\$ 17,477</u> | <u>\$ 20,823</u> | <u>\$ 35,231</u> | <u>\$ 17,881</u> | <u>\$ 17,657</u> |

(a) Financial data presented for periods prior to January 1, 2004 have not been restated to reflect the new rehabilitation business alignment.

KINDRED HEALTHCARE, INC.

Condensed Business Segment Data (Continued)

(Unaudited)

| | 2003 Quarters | | | | 2004 Quarters | |
|-------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | First | Second | Third | Fourth | First | Second |
| Hospital data: | | | | | | |
| End of period data: | | | | | | |
| Number of hospitals | 63 | 63 | 64 | 66 | 68 | 70 |
| Number of licensed beds | 5,076 | 5,098 | 5,129 | 5,219 | 5,323 | 5,474 |
| Revenue mix % (a): | | | | | | |
| Medicare | 60 | 59 | 62 | 63 | 66 | 64 |
| Medicaid | 8 | 8 | 7 | 8 | 7 | 8 |
| Private and other | 32 | 33 | 31 | 29 | 27 | 28 |
| Admissions: | | | | | | |
| Medicare | 6,612 | 6,346 | 6,053 | 6,681 | 6,900 | 6,816 |
| Medicaid | 648 | 604 | 670 | 661 | 715 | 820 |
| Private and other | 1,281 | 1,322 | 1,333 | 1,359 | 1,460 | 1,588 |
| | <u>8,541</u> | <u>8,272</u> | <u>8,056</u> | <u>8,701</u> | <u>9,075</u> | <u>9,224</u> |
| Admissions mix %: | | | | | | |
| Medicare | 77 | 77 | 75 | 77 | 76 | 74 |
| Medicaid | 8 | 7 | 8 | 7 | 8 | 9 |
| Private and other | 15 | 16 | 17 | 16 | 16 | 17 |
| Patient days: | | | | | | |
| Medicare | 216,266 | 214,116 | 193,069 | 191,904 | 207,052 | 201,580 |
| Medicaid | 31,764 | 32,470 | 31,362 | 29,488 | 27,754 | 29,293 |
| Private and other | 56,225 | 59,339 | 54,080 | 52,725 | 52,391 | 53,031 |
| | <u>304,255</u> | <u>305,925</u> | <u>278,511</u> | <u>274,117</u> | <u>287,197</u> | <u>283,904</u> |
| Average length of stay: | | | | | | |
| Medicare | 32.7 | 33.7 | 31.9 | 28.7 | 30.0 | 29.6 |
| Medicaid | 49.0 | 53.8 | 46.8 | 44.6 | 38.8 | 35.7 |
| Private and other | 43.9 | 44.9 | 40.6 | 38.8 | 35.9 | 33.4 |
| Weighted average | 35.6 | 37.0 | 34.6 | 31.5 | 31.6 | 30.8 |
| Revenues per admission (a): | | | | | | |
| Medicare | \$ 30,050 | \$ 31,594 | \$ 35,157 | \$ 30,987 | \$ 33,321 | \$ 33,397 |
| Medicaid | 40,547 | 44,766 | 36,974 | 37,825 | 33,228 | 32,952 |
| Private and other | 83,449 | 83,830 | 77,860 | 68,870 | 65,054 | 63,384 |
| Weighted average | 38,855 | 40,904 | 42,374 | 37,423 | 38,419 | 38,520 |
| Revenues per patient day (a): | | | | | | |
| Medicare | \$ 919 | \$ 936 | \$ 1,102 | \$ 1,079 | \$ 1,110 | \$ 1,129 |
| Medicaid | 827 | 833 | 790 | 848 | 856 | 922 |
| Private and other | 1,901 | 1,868 | 1,919 | 1,775 | 1,813 | 1,898 |
| Weighted average | 1,091 | 1,106 | 1,226 | 1,188 | 1,214 | 1,252 |
| | N/A | N/A | N/A | 1.20 | 1.26 | 1.25 |

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Medicare case mix index (discharged patients only)

| | | | | | | |
|----------------------|-------|-------|-------|-------|-------|-------|
| Average daily census | 3,381 | 3,362 | 3,027 | 2,980 | 3,156 | 3,120 |
| Occupancy % | 69.8 | 69.0 | 61.9 | 59.9 | 62.4 | 60.1 |

(a) Includes income of \$14 million in the third quarter of 2003, \$2 million in the first quarter of 2004 and \$4 million in the second quarter of 2004 related to certain Medicare reimbursement issues.

N/A not available.

KINDRED HEALTHCARE, INC.

Condensed Business Segment Data (Continued)

(Unaudited)

| | 2003 Quarters | | | | 2004 Quarters | |
|---|------------------|------------------|------------------|------------------|------------------|------------------|
| | First | Second | Third | Fourth | First | Second |
| Nursing center data: | | | | | | |
| End of period data: | | | | | | |
| Number of nursing centers: | | | | | | |
| Owned or leased | 248 | 248 | 248 | 248 | 247 | 245 |
| Managed | 7 | 7 | 7 | 7 | 7 | 7 |
| | <u>255</u> | <u>255</u> | <u>255</u> | <u>255</u> | <u>254</u> | <u>252</u> |
| Number of licensed beds: | | | | | | |
| Owned or leased | 32,293 | 32,124 | 32,118 | 32,124 | 32,009 | 31,786 |
| Managed | 803 | 803 | 803 | 803 | 803 | 803 |
| | <u>33,096</u> | <u>32,927</u> | <u>32,921</u> | <u>32,927</u> | <u>32,812</u> | <u>32,589</u> |
| Revenue mix %: | | | | | | |
| Medicare | 33 | 33 | 32 | 33 | 36 | 33 |
| Medicaid | 48 | 48 | 50 | 48 | 46 | 49(a) |
| Private and other | 19 | 19 | 18 | 19 | 18 | 18 |
| Patient days (excludes managed facilities): | | | | | | |
| Medicare | 398,646 | 399,150 | 394,957 | 397,254 | 433,162 | 407,285 |
| Medicaid | 1,699,726 | 1,707,907 | 1,757,580 | 1,737,615 | 1,675,706 | 1,689,795 |
| Private and other | 410,378 | 418,824 | 422,529 | 426,890 | 407,684 | 409,346 |
| | <u>2,508,750</u> | <u>2,525,881</u> | <u>2,575,066</u> | <u>2,561,759</u> | <u>2,516,552</u> | <u>2,506,426</u> |
| Patient day mix %: | | | | | | |
| Medicare | 16 | 16 | 15 | 15 | 17 | 16 |
| Medicaid | 68 | 68 | 68 | 68 | 67 | 68 |
| Private and other | 16 | 16 | 17 | 17 | 16 | 16 |
| Revenues per patient day: | | | | | | |
| Medicare | \$ 338 | \$ 342 | \$ 344 | \$ 364 | \$ 372 | \$ 375 |
| Medicaid | 117 | 118 | 123 | 120 | 121 | 134(a) |
| Private and other | 188 | 189 | 188 | 190 | 197 | 197 |
| Weighted average | 164 | 165 | 168 | 169 | 177 | 184 |
| Average daily census | 27,875 | 27,757 | 27,990 | 27,845 | 27,654 | 27,543 |
| Occupancy % | 86.0 | 85.6 | 86.8 | 86.4 | 86.0 | 85.8 |
| Rehabilitation data: | | | | | | |
| Revenue mix %: | | | | | | |
| Company-operated | N/A | N/A | N/A | N/A | 70 | 71 |
| Non-affiliated | N/A | N/A | N/A | N/A | 30 | 29 |
| Pharmacy data: | | | | | | |

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| Number of customer licensed beds at end of period: | | | | | | |
|--|---------------|---------------|---------------|---------------|---------------|---------------|
| Company-operated | 29,804 | 27,566 | 27,886 | 28,280 | 28,188 | 28,164 |
| Non-affiliated | 28,365 | 28,848 | 29,507 | 33,127 | 35,102 | 36,385 |
| | <u>58,169</u> | <u>56,414</u> | <u>57,393</u> | <u>61,407</u> | <u>63,290</u> | <u>64,549</u> |

(a) Includes income of \$9 million related to prior period North Carolina provider tax program revenues. Prior period provider tax expense of \$3 million related to this program was recorded in other operating expenses.

N/A not available.